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Politics this week

Jun 16th 2005
From The Economist print edition

Iraq's continuing violence

The insurgency in **Iraq** showed no sign of abating, with a suicide-bomber killing at least 22 people, mostly Kurds, in the disputed city of Kirkuk, and another killing more than 25 Iraqi soldiers in Khalis, north of Baghdad. A peace-minded Sunni group rejected an offer by the Shia-led government to have more Sunnis in the committee drafting a constitution.

See article

In the run-up to **Iran's** presidential election on June 17th, bombs went off in the ethnic-Arab town of Ahwaz, killing seven people, and in Tehran, the capital, killing three.

AP

See article

Iran has again changed its **nuclear** story. It admitted to the IAEA that it had experimented with plutonium (a possible bomb ingredient) several times, as suspected, and not once as it had first claimed.

A former **Lebanese** army commander, Michel Aoun, did well in the third of four rounds of a general election, raising the possibility of his holding the balance of power in a new parliament between pro- and anti-Syrian groups.

After his expected re-election in September, **Egypt's** President Hosni Mubarak would appoint a vice-president for the first time during his 24 years in office, according to his official spokesman. But Mr Mubarak's son Gamal, frequently mooted as his father's successor, said he had no plans to become president—for the moment.

South Africa's vice-president, Jacob Zuma, was sacked by President Thabo Mbeki, after a judge said that Mr Zuma had a “corrupt relationship” with his adviser, Schabir Shaik, who had been sentenced earlier this month for corruption.

See article

Finance ministers from the world's seven richest countries, the G7, agreed to a debt-relief programme worth about $40 billion for the most indebted countries, most of them in **Africa**.

See article

It's never too late

The Senate issued a rare official apology for blocking federal **anti-lynching** legislation in the first half of the 20th century; over 4,700 people are documented as having been lynched between 1862 and 1968. Legislation to force local authorities to tackle the issue fell to filibusters.

See article

California's governor, Arnold Schwarzenegger, called a special election for

EPA

November 8th. The state's election-weary voters (this is the fourth statewide ballot in just over two years) will be asked to support Mr Schwarzenegger's complex political-reform agenda.

The House of Representatives unexpectedly voted down a measure in the **Patriot Act** that curtails the FBI's powers to seize the library records of suspected terrorists. George Bush is lobbying hard for the renewal of the legislation.

The Centres for Disease Control estimated that up to 1.2m people were living with **HIV** in the United States at the end of 2003, up from previous years. The higher estimate is partly explained by the effectiveness of new drugs that kept HIV patients alive longer.

In **Virginia's** primary election, Jerry Kilgore, a former state attorney-general, won the Republican nomination for governor and will now face Timothy Kaine, the current Democratic lieutenant-governor, in November.

A definite lack of cordialité

The leaders of **France and Britain** clashed ahead of a European Union summit. Jacques Chirac demanded that Britain give up its EU budget rebate; Tony Blair insisted that the common agricultural policy should be renegotiated. The summit seemed unlikely to settle the argument.

See article

The president of the **European Commission**, José Manuel Barroso, issued a gloomy warning that a failure at the European Union summit might mean that the EU would sink into “a permanent crisis and paralysis”.

Four political bigwigs wrote to EU leaders urging that the door be kept open to membership for the countries of the **western Balkans**. If the door was shut, they said, Europe might risk “a new Srebrenica”.

A referendum to overturn parts of a restrictive **Italian fertility law**, adopted last year, failed as turnout, which had to be 50% for the vote to pass, was only 26%. The pope and Catholic bishops had urged Italians not to vote.

See article

A **French journalist** who had been held hostage in Iraq since early January was freed, with her Iraqi interpreter. Florence Aubenas returned to a heroine's welcome in Paris—the government denied that any ransom had been paid.

Political shakes

President Ricardo Lagos cut short his visit to Europe to fly back to **Chile** after an earthquake in the remote northern part of the country, measuring 7.9 on the Richter scale, killed 11 people and injured some 200 others.

At least five inmates were killed in riots between rival gangs in a jail in **Brazil's** São Paulo state. Their severed heads were displayed on stakes on the jail's roof where prisoners were holding 20 guards hostage. It is thought they were unhappy about the transfer of fellow inmates to a different jail.

In a judgment that could have implications for the whole of **Canada's** prized public health system, the federal Supreme Court ruled that Quebec's ban on private health insurance for “medically necessary” health services was unconstitutional.

See article

Trying to keep on track

A bomb in the Indian-controlled **Kashmiri** town of Pulwama killed 16 people and wounded many more. Pakistan's president, Pervez Musharraf, vowed that the incident would not derail the India-Pakistan peace process.

Three hundred South Koreans travelled to **North Korea** to celebrate the fifth anniversary of a summit that sought to improve relations on the peninsula. However, tension over North Korea's nuclear programme caused Pyongyang to ask Seoul to scale down the size of its delegation.

Reuters

Microsoft agreed to block the words “democracy” and “freedom” on its new internet portal in **China**. The company claimed that it was acting in accordance with its principle of respecting local laws.

At an international conference on foreign investment, Nursultan Nazarbaev, **Kazakhstan's** president, warned against importing democracy too rapidly to Central Asia. The remarks came against the backdrop of recent protests that swept away the government in Kirgizstan and led to a violent crackdown in Uzbekistan.

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Business this week

Jun 16th 2005
From The Economist print edition

UnfulPhilled

Morgan Stanley's chief executive, Philip Purcell, said that he would step down as soon as a successor could be found (but no later than next March). Mr Purcell had faced a vocal campaign for his removal from several former executives of the firm. Morgan Stanley also issued a warning that its earnings for the current quarter may be 15-20% lower than a year ago.

See article

Lehman Brothers, a rival of Morgan Stanley's, reported a net profit of $683m for the quarter ending May 31st, 12% more than a year before.

UniCredit, Italy's largest bank, finalised an agreement to acquire **HVB Group**, Germany's second-largest, for *euro*15.4 billion ($18.6 billion). With HVB's listed affiliates, the deal is worth *euro*19 billion. It is Europe's largest cross-border banking merger.

See article

BNP Paribas, a large French bank, said it was buying **Commercial Federal**, a mortgage bank based in Nebraska and the mid-west, for $1.36 billion through its American subsidiary, BancWest.

J.P. Morgan Chase agreed to pay $2.2 billion to settle its part in a class-action lawsuit, led by the University of California, that accuses several banks of aiding Enron in defrauding investors before the energy trader went bankrupt in December 2001. Last week, **Citigroup** said it would pay $2.0 billion to settle its part in the suit. Both banks deny any wrongdoing.

The MP3 generation

Ericsson announced a deal that will enable the downloading of **Napster's** online digital music to mobile phones. The service will be offered by the mobile-network provider to operators worldwide and is the latest move to integrate music provision with mobile phones. Motorola announced a tie-up package with Apple's iTunes last year.

Hewlett-Packard is separating its printer and personal computer units, five months after Carly Fiorina, who resigned as chief executive in February, combined them on efficiency grounds. HP's printer group accounts for most of its profit; some analysts have suggested that HP should sell its PC business.

PartyGaming, the world's leading online poker site, announced details of its forthcoming flotation in London. The company, based in Gibraltar, is valued at around £4.8 billion ($8.6 billion), about £1 billion less than most recent estimates. Maybe 90% of PartyGaming's customers are based in the United States, where the legal status of online gambling is unclear.

Blackstone, a private-equity group, agreed to buy **Wyndham International**, an upmarket hotelier that operates in Europe and North America, for $3.2 billion.

Back to the great universe

Kim Woo-choong, the former head of **Daewoo Group**, returned home to South Korea, after almost six years as a fugitive, to face arrest. The *chaebol* collapsed in 1999 with debts of $80 billion. Mr Kim, its founder, is accused, among other things, of inflating the group's assets by $41 billion. Daewoo once employed 200,000 people worldwide and had sales of $60 billion.

Viacom confirmed that it was splitting its assets into two separate companies. One company will retain Viacom's name and be based on its cable networks; the other company will be based on CBS, which merged with the media conglomerate in 1999.

See article

Two former executives at **Bristol-Myers Squibb** were indicted by federal prosecutors for their part in an accounting scandal at the drugs firm. The charges relate to a manipulation of revenues that overstated profits by some $900m. Bristol-Myers agreed to pay $300m to settle allegations levelled against the company.

Pfizer said it was buying **Vicuron Pharmaceuticals**, a drug firm that specialises in developing treatments for infectious diseases, for $1.9 billion.

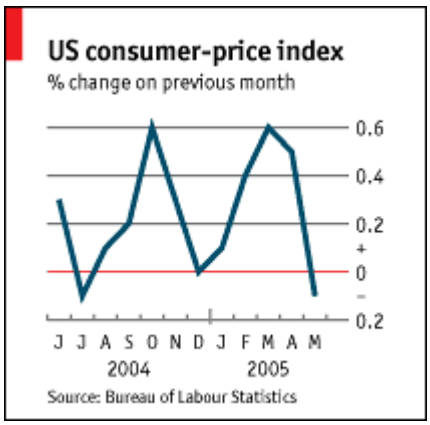
Ford filed preliminary documents to float **Hertz**, its car-rental business that it wholly owns. The carmaker was downgraded to “junk” status last month, making it difficult for the company to raise cash. It may still decide to sell Hertz, estimated to be worth $4 billion-6 billion, to a third party.

OPEC said it would raise its official production to 28m barrels per day (the cartel is already pumping out close to 30m) from July 1st and would raise it again if **oil prices** stayed high. With prices trading at over $55 per barrel, the news had little immediate effect.

See article

Not so pricey

America's headline **consumer-price index** fell by 0.1% in May, the first drop in ten months (core consumer prices, excluding food and energy, rose by 0.1%). Consumer prices were 2.8% higher than a year earlier. Consumer energy prices were the primary factor—they fell by 2% in May, the biggest drop since July 2004.



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House prices

After the fall

Jun 16th 2005
From The Economist print edition

Soaring house prices have given a huge boost to the world economy. What happens when they drop?

PERHAPS the best evidence that America's house prices have reached dangerous levels is the fact that house-buying mania has been plastered on the front of virtually every American newspaper and magazine over the past month. Such bubble-talk hardly comes as a surprise to our readers. We have been warning for some time that the price of housing was rising at an alarming rate all around the globe, including in America. Now that others have noticed as well, the day of reckoning is closer at hand. It is not going to be pretty. How the current housing boom ends could decide the course of the entire world economy over the next few years.

This boom is unprecedented in terms of both the number of countries involved and the record size of house-price gains. Measured by the increase in asset values over the past five years, the global housing boom is the biggest financial bubble in history (see article). The bigger the boom, the bigger the eventual bust.

Throughout history, financial bubbles—whether in houses, equities or tulip bulbs—have continued to inflate for longer than rational folk believed possible. In many countries around the globe, house prices are already at record levels in relation to rents and incomes. But, as demonstrated by dotcom shares at the end of the 1990s, some prices could yet rise even higher. It is impossible to predict when prices will turn. Yet turn they will. Prices are already sliding in Australia and Britain. America's housing market may be a year or so behind.

Many people protest that house prices are less vulnerable to a meltdown. Houses, they argue, are not paper wealth like shares; you can live in them. Houses cannot be sold as quickly as shares, making a price crash less likely. It is true that house prices do not plummet like a brick. They tend to drift downwards, more like a brick with a parachute attached. But when they land, it still hurts. And there is a troubling similarity between the house-price boom and the dotcom bubble: investors have been buying houses even though rents will not cover their interest payments, purely in the expectation of large capital gains—just as investors bought shares in profitless firms in the late 1990s, simply because prices were rising.

Homes as cash machines

One other big difference between houses and shares is more cause for concern than comfort: people are much more likely to borrow to buy a house than to buy shares. In most countries, the recent surge in house prices has gone hand-in-hand with a much larger jump in household debt than in previous booms. Not only are new buyers taking out bigger mortgages, but existing owners have increased their mortgages to turn capital gains into cash which they can spend. As a result of such borrowing, housing booms tend to be more dangerous than stockmarket bubbles, and are often followed by periods of prolonged economic weakness. A study by the IMF found that output losses after house-price busts in rich countries have, on average, been twice as large as those after stockmarket crashes, and usually result in a recession.

The economic damage this time could be worse than in the past because house prices are more likely to fall in nominal, not just real terms. Not only do houses in many countries look more overvalued than at previous peaks, but with inflation so low, prices would have to stay flat for at least a decade to bring real prices back to long-run average values. Most important of all, in many countries this house-price boom has been driven far more by investors than in the past, and if prices start to dip, they are more likely to sell than owner-occupiers. In America this could mean the first fall in average house prices since the Great Depression. Owners who have been using their home like an ATM to extract cash, or who were relying on rising house prices to provide them with a comfortable pension, will suddenly realise that they need to start saving the old-fashioned way—by spending less of their income.

The Fed frets

The lesson from recent experience in Australia, Britain and the Netherlands is that, contrary to conventional wisdom, a big rise in interest rates is not necessary to make house prices falter. This is bad news for America. Even if prices there initially just flatten rather than fall, this will hurt consumer spending as the impulse to borrow against capital gains disappears. It is by encouraging such borrowing that rising house prices have given a bigger boost to America's economy than elsewhere. Two-fifths of all American jobs created since 2001 have been in housing-related sectors such as construction, real-estate lending and broking. If house prices actually fall, this boost will turn into a substantial drag.

No wonder that the Federal Reserve is starting, belatedly, to fret about house prices. By holding interest rates low for so long after equities crashed, the Fed helped to inflate house prices. This prevented a deep recession, but it may have merely delayed the needed economic adjustments. Ideally, the Fed should have tried to cool the housing boom by raising interest rates sooner and by giving clear verbal warnings to buyers, as Britain's and Australia's central banks have done. Even now some stern words from Alan Greenspan, the Fed's chairman, could restrain more house-price inflation.

Of course, by the time American prices begin to fall, probably sometime next year, they will not be Mr Greenspan's headache. He will have retired and someone else will be in his job. If weaker house prices push the economy towards recession, the awkward truth is that America's policymakers will have much less room to manoeuvre than they did after the stockmarket bubble burst. Short-term interest rates of only 3% leave less scope for cuts. In 2000, America had a budget surplus. Today it has a large deficit, ruling out big tax cuts.

The whole world economy is at risk. The IMF has warned that, just as the upswing in house prices has been a global phenomenon, so any downturn is likely to be synchronised, and thus the effects of it will be shared widely. The housing boom was fun while it lasted, but the biggest increase in wealth in history was largely an illusion.

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Iraq

To leave or not to leave?

Jun 16th 2005
From The Economist print edition

The news from Iraq is bad. America should stay, but stay to win

Reuters

Get article background

"FREEDOM is messy," quipped a complacent Donald Rumsfeld when Iraqis looted Baghdad after the arrival of the Americans in April 2003. More than two years of occupation later, Iraq is in a far bloodier mess than America's defence secretary can ever have expected. Despite the election in January, in which 8m Iraqis risked life and limb to elect a government, the insurgency has waxed, not waned. Almost every day brings its new harvest of murder and mayhem. Some 1,600 American soldiers, and perhaps 25,000 Iraqis, have been killed since George Bush announced the end of major combat operations in May 2003. It was no surprise when Gallup reported this week that almost six out of ten Americans now want to see some or all of their troops come home.

Where can Iraq go from here? According to the brave face worn by official Washington, the plan is on course and the way forward is clear. The national assembly Iraqis elected last January will by August complete the first draft of a new constitution. This will in turn be put to a popular referendum by October. Elections under the new constitution will follow. In the meantime, America will shortly begin to transfer much of the military burden to Iraqi forces. But it would take an ostrich not to notice the gap between the official optimism in Washington and the military and political facts on the ground.

As our special report makes clear (see article), America's forces in Iraq are at full stretch and yet still failing to suppress the insurgency. It will take years rather than months to raise loyal Iraqi forces capable of taking their place: recent talk of shipping lots of troops home early next year looks wildly unrealistic. As for the politics, January's election was flawed by the failure of most Sunnis to vote. The election has since had the proper but awkward side-effect of reducing America's ability to tell the Shia- and Kurdish-dominated government what to do. The new government has so far resisted the entreaties of both Mr Bush and Condoleezza Rice, his secretary of state, to go further than it has in giving the Sunnis, under-represented in government but over-represented in the insurgency, a bigger say in writing the constitution.

The case for quitting

In these circumstances, America and its dwindling band of allies are entitled to consider whether the

least bad option might now be, in the pejorative jargon, to “cut and run”. A respectable case for leaving early can certainly be made. To the extent that the insurgency is driven by a simple hatred of foreign military occupation, the departure of the Americans might douse much of the fire. The withdrawal of their protector might compel the Shias and Kurds to show more generosity to the anxious Sunnis. Freed from its all-absorbing Iraqi entanglement, America could focus more on a broader strategy against terrorism, one that might include fostering democracy in the wider region and doing more to win back Muslim hearts and minds, not least by delivering an independent Palestine.

It is a beguiling argument. But ostriches exist on both sides of this debate. The risks entailed in leaving early may well be much larger than those entailed in staying on. For a start, it is far from clear that America's departure would suck the energy out of the insurgency, only part of which is motivated by a desire to resist the foreigner. Two other strong motives are the desire by Iraq's previous Sunni masters to prevent power from passing via the ballot box to the Shia majority, and growing support in Iraq for the *jihadi* worldview espoused by al-Qaeda and its local lieutenant, Abu Musab al-Zarqawi. A famous victory against the superpower would encourage many of them to redouble their efforts against the elected government.

Worse, the consequences would not be confined to Iraq. America's recent modest success in promoting democracy in the wider Middle East since the toppling of Saddam could be thrown rapidly into reverse: Arabs will not rush to emulate a democratic experiment that collapses. And more is at stake than the power of example. Once they believed they had cast out the Americans, the Iraqi *jihadis* would doubtless copy those who pushed the Soviet Union out of Afghanistan, and celebrated by exporting their struggle to the Middle East, North Africa, Kashmir, the Balkans and, on September 11th 2001, to the United States as well. In short, an American departure might well placate Muslim sentiment as a whole but at the same time embolden the groups who have declared war not only on “Jews and Crusaders” but also on secular regimes in Muslim lands around the world.

For the present, the case for seeing the job through therefore remains compelling. But America will fail in Iraq unless Mr Bush is honest about what is at stake and how much victory will cost. He could start by ending the fiction that the military work can shift any time soon to Iraqis themselves. Indeed, if America is serious about vanquishing this insurgency, it needs more rather than fewer American boots on the ground. Mr Rumsfeld has a visionary's fixation on the high-tech “transformation” of America's military and a misplaced disdain for the plain old infantry. He would do better to transform his own thinking. To prevail in Iraq, America needs urgently to raise new forces that can be committed to a low-intensity counter-insurgency that might drag on for years.

A stronger military effort will have to be matched by more robust political engagement. In particular, the world needs to impress on Iraq's new government that even with America at its side it will not defeat the insurgents unless it can drive a wedge between the Sunni mainstream and the al-Qaeda diehards. That means the government will have to listen to the Sunnis' anxieties about their future, forgive some past sins and give them a stronger hand in writing the constitution. America and its allies will have a good chance to insist on all this next week in Brussels, where at Iraq's request foreign ministers from America, Europe and the Arab states are meeting to rally support for the government. That support should be made contingent on a stronger Shia and Kurdish effort to share power with Iraq's former masters. This will not be an easy thing for the new government to do, but it should be forced to comply. More is still at stake than Iraq itself.

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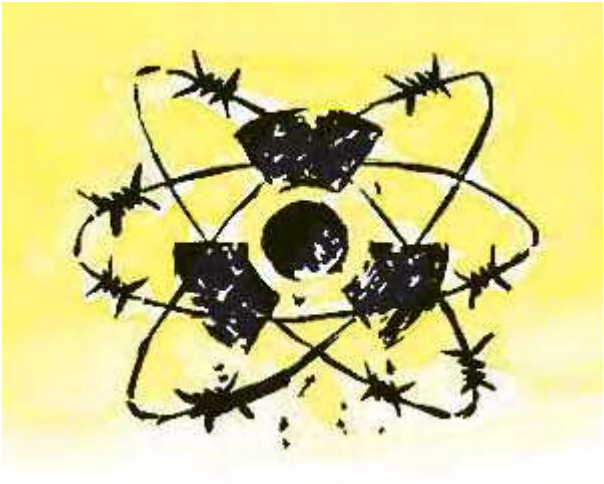
The G8's forgotten summit priority

Finish what you started

Jun 16th 2005
From The Economist print edition

Three years on, the G8's nuclear clean-up is still falling short



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WOULD any sane government disagree? There is no more urgent mission than to keep weapons of mass destruction out of the hands of terrorists. Alarmed by what groups like al-Qaeda might try next, G8 leaders (representing the G7 richer nations and Russia) used their first annual summit after the September 11th terrorist attacks on America to put more money and determination into a long-running American-led effort to dismantle weapons and secure poorly protected nuclear, chemical and biological materials in Russia and the countries of the former Soviet Union. Collectively, they pledged a tidy $20 billion over ten years (with America agreeing to provide the first $10 billion) to finish the job. That was three summits ago. When the G8 summiteers next meet, early in July at Gleneagles in Scotland, the promised fund will still be about $3 billion short of its target.

Money isn't the only problem. And despite the continuing shortfall there is still plenty of good work going on, putting fences and guards around nuclear storage sites, helping to build the facilities where mouldering chemical shells can safely be destroyed, etc. But there is also plenty more to be done, including recovering poorly-guarded nuclear materials from research reactors around the world (see article). And the shortfall in pledges is symptomatic of other difficulties that have beset the clean-up effort. The good news is that, with enough political will, these problems are fixable. The bad news is that terrorists with an interest in filching scientific know-how and weapons materials are unlikely to be sitting on their hands while the fixing drags on.

At each G8 summit the host inevitably likes to pick a new theme. This year Britain's Tony Blair wants the group to focus on aid to Africa and the challenge of climate change. Both are worthy of top-level attention. But the G8 leaders still need to meet their earlier clean-up commitment. Japan has the world's second-largest economy, yet its promised $200m so far is niggardly. Some (not all) European countries chip in and do useful work, including several not at the G8 table, but the European Union as whole, which has plenty of aid money for other projects, has done too little to cope with an acute security risk that could just as easily result in a catastrophic attack in Paris or Berlin as in New York or Washington.

Next year Russia will chair the G8. You might think that would put the weapons clean-up back near the top of the agenda. But Russia has its own priorities and sensitivities. It wants more of the cash to go into destroying its vast stockpiles of chemical weapons (which it is obligated to get rid of under the Chemical

Weapons Convention) and dismantling decommissioned nuclear-powered submarines (an acknowledged environmental hazard). Yet it is terrorists getting their hands on a nuclear weapon, or managing to buy or steal enough highly-enriched uranium or plutonium to make a crude bomb, that is the more urgent threat. Locking down more of its nuclear materials, however, requires Russia to allow foreigners access to some of its most sensitive sites, and its nuclear bureaucrats have unhelpfully dragged their feet.

The stakes could not be higher. Whatever else they talk about, at Gleneagles all need to focus on ways to speed the nuclear clean-up. For among those likely to suffer from the fallout if a new terrorist-inspired catastrophe rocks the rich world's economies are precisely the poorer countries, in Africa as elsewhere, that this year's summiteers are keenest to help.

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About sponsorship

Trade

The CAFTA conundrum

Jun 16th 2005
From The Economist print edition

A trade deal that must be passed but should not be repeated

FOR all their protectionist rhetoric, America's lawmakers have not rejected any trade deal negotiated by an American president for almost 40 years. Lyndon Johnson was the last president to suffer this rebuff when Congress threw out several provisions of the Kennedy round of global tariff cuts in 1967. Unfortunately, George Bush is now perilously close to suffering a similar embarrassment.

At issue is the Central American Free Trade Agreement (CAFTA), a deal between the United States and five countries in Central America plus the Dominican Republic. Although the agreement was signed more than a year ago, Congress has yet to ratify it. This week CAFTA cleared its first hurdles in two congressional committees. The White House is hoping for full passage by the end of this month. But despite enormous pressure—Mr Bush has declared the deal to be his top trade priority—CAFTA's fate is still uncertain, and it may yet be defeated by a combination of powerful sugar growers, protectionist trade unions and partisan rancour.

In economic terms it is hard to see what all the fuss is about. Although CAFTA is important for Central Americans, whose main hope is for increased American investment, it will have only a small effect on America's economy. The combined output of the CAFTA countries is around $85 billion, about the size of the economy of Nevada. America already allows into its market almost 80% of these countries' exports tariff-free. And CAFTA's additional opening of America's most protected industries, such as sugar, is tiny.

In truth, CAFTA's significance is not its substance but what it symbolises for both supporters and opponents. The sugar lobby regards any increase in access for Central American sugar as a first step towards dismantling the defences that sustain this molly-coddled industry. Hence the huge pressure on congressmen from sugar areas, many of whom are usually free-trade Republicans, to vote against the agreement.

Democrats have their own special interests to contend with. For the unions, CAFTA has become a scapegoat for general fears about globalisation and the future of American jobs. For the party's leaders in Congress, the calculus is even more partisan. Intoxicated with their success, thus far, at stymieing Mr Bush's agenda on social security reform, the Democrats are determined to deal their nemesis a big blow on CAFTA.

Precisely because it has become a surrogate for so many other battles, the CAFTA outcome matters for the rest of the world. In the short term, the outlook for the Doha round of global trade talks, where a big breakthrough is needed by the end of this year, will be coloured by CAFTA's fate. If Congress rejects a small trade deal in its own back garden, what confidence can other countries have that American lawmakers will agree to a far more ambitious global deal? Rob Portman, Mr Bush's new trade negotiator, who hails from Congress, would be in a much weaker position (see article). Equally, the nature of any CAFTA compromise has global consequences. If Mr Bush gets CAFTA through Congress only by surrendering to the sugar lobby, the signals for Doha—and the prospect for progress in opening up sensitive farm sectors—will be grim. More broadly, freer global trade has long hinged on American leadership, and that leadership has depended on the commitment of a bipartisan group of free traders in Congress. If Democrats choose to stick with protectionism and partisan point-scoring, America's ability to lead will evaporate.

The jackpot

To avoid these outcomes, CAFTA needs to pass. Mr Bush must defeat the sugar lobby. The pro-trade Democrats must stand up to their short-sighted leaders. But once CAFTA has passed, Mr Bush must rethink his own trade strategy, especially its focus on pushing bilateral and regional deals in tandem with the Doha round. In economic terms, the focus on bilateralism was always dubious. A web of bilateral and regional deals is unequivocally inferior to freer global trade. The CAFTA fight has cast doubt on the strategy's political logic as well. Why spend so much capital on a deal of such small economic consequences? From now on, Mr Bush should focus on the really big prize—winning a successful global trade deal.

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The European Union

Summit shenanigans

Jun 16th 2005
From The Economist print edition

European leaders should be debating the Union's future, not squabbling over money

THE timing of European Union summits is often awkward. This week's began after *The Economist* went to press and will be over by the time we reach many readers. Yet even before EU leaders had gathered in Brussels, it was clear that they had made mistakes in the run-up to the meeting.

The biggest was not to pay more respectful attention to the French and Dutch voters who, only a few weeks ago, resoundingly rejected the EU constitution. Instead, the summit was poised to lapse into yet another row about the EU budget. Britain's Tony Blair and France's Jacques Chirac spent much of the week before the summit trading blows, after Mr Chirac demanded that Britain make a “gesture of solidarity” by giving up part or all of its EU budget rebate, first granted in 1984. Mr Blair countered not only that Britain paid a lot more than France, but also that Mr Chirac should accept deeper reform of the common agricultural policy, first set up in 1962. This budget row will seem arcane to many (see our bluffers' guide). Since both men have a veto, it can be settled only if both are willing to move: Mr Chirac must put the CAP and its financing on the table and, in exchange, Mr Blair must be willing to forgo part or all of the rebate. Because neither seemed ready to give ground this week, a deal was always unlikely.

That makes it especially unfortunate that the current Luxembourg presidency of the EU chose to press so hard for one. The argument of Luxembourg's prime minister, Jean-Claude Juncker, was that it was vital to strike a deal on the budget, to demonstrate that, despite the shock of the no votes in France and the Netherlands, the EU could continue to function normally. Yet there is no real urgency about settling the budget; and it is arrogant of EU leaders to pretend to carry on as usual in the face of such a huge popular rejection of all they have been doing. Instead, they should have used this summit to kick off a period of serious reflection and debate about what their Union is for and where it ought to be going.

The worst way to start such a debate is to squabble over money. Instead, Europe's leaders should have quickly recognised that, after the conclusive Franco-Dutch rejections, the constitution in its present form is dead. It seems that one or two countries (including Mr Juncker's own Luxembourg) may still choose to put it to the vote, but most surely will not. It would thus be best to put the constitution into cold storage for at least a few years—and possibly forever—while a proper debate about the Union's future takes place.

Next, however, EU leaders must do their utmost to ensure that failure of the constitution does not wreak undesirable collateral damage. That means, above all, not letting it stop plans for future expansion of the club, even if it may mean some delay. The entry of Romania and Bulgaria ought to proceed as planned, preferably in 2008 or 2009. The EU should also make clear to the countries of the western Balkans that

the door to membership remains open. There are two answers to those who argue that rejection of the constitution signified also rejection of further enlargement. One is that most voters were surely thinking of Turkey, not the Balkans. The second is that the Balkan countries will be more costly and disruptive to the EU if they are kept out than if, one day, they are let in.

Turkey itself is far more problematic. Many French and Dutch voters cited the country's prospective entry as a reason for saying no to the EU constitution. But EU leaders should, even so, keep to the timetable they promised last December of starting entry talks with Turkey on October 3rd. The risks, to both the EU and Turkey, of saying no are unacceptably high. And because negotiations with Turkey will last at least ten years, European leaders can legitimately reassure voters that there is no guarantee—on either the EU's or Turkey's side—that entry talks will automatically lead to full membership.

Liberal and outward, or protected and inward

More fundamentally, EU leaders, especially but not only from France and the Netherlands, should now be reflecting more thoughtfully than they seem to have done so far on the message the voters were sending them by rejecting the constitution. Of course the voters were dissatisfied with their national governments, particularly over their failure to deliver stronger economic growth and more jobs, and with the perceived rapidity of enlargement if not with enlargement per se. But they were also expressing an instinctive, strong hostility to a remote, bureaucratic and intrusive Europe.

There are, in principle, two different ways of responding to this message. One, favoured by Mr Blair and most of the new EU members from central Europe, is to press forward with an economically liberal, outward-looking and expanding EU that, freed from unnecessary Brussels interference, regains its economic dynamism. The other, seemingly preferred by Mr Chirac and some older members, is to turn inwards and seek to shore up the protection that surrounds the EU's supposed social model. All experience suggests that the first approach would do more to revitalise Europe's economy and to create jobs. But what Europe needs now is a full debate about the relative merits of each response.

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Bolivia

Mob rule, not people power

Jun 16th 2005
From The Economist print edition

Some dangerous fairy tales about what is going on in South America

EPA

A SEMBLANCE of normality has returned to Bolivia after a month of protests and road blocks by miners, peasants and workers. They achieved one of their objectives: 19 months after similar protests had toppled the elected president, his ineffectual successor, Carlos Mesa, resigned. Bolivia's Congress swore in as a caretaker Eduardo Rodríguez, the head of the Supreme Court, who will probably hold an early general election. The protest leaders also want to nationalise Bolivia's oil and gas industry and convene a constituent assembly.

Much commentary has seen in these events a popular revolution by downtrodden Andean Indians. The protesters are held to represent a majority of Bolivians, while the government is that of a rapacious white elite. The protestors are waging a righteous struggle against “neo-liberal” reforms imposed by “Washington”, the IMF and other villains. The only beneficiaries of these reforms, which included the privatisation of the oil and gas industry, are said to be predatory multinationals. As in the best fairy tales, a happy ending is at hand. The election will be won by Evo Morales, the utopian socialist who leads the coca workers. Nationalisation of gas will end poverty and the constituent assembly will rewrite the constitution to make Bolivia racially inclusive. The bottom line, one pundit told the *New York Times*, is that Latin America is in open rebellion against the economic policies of the “Washington consensus”. Others compared Bolivia's upheavals to recent examples of people power from Ukraine to Kirgizstan.

Fiddlesticks. It is true that Bolivia's Andean Indians, who make up some three-fifths of the population, have faced discrimination, that wealthy “white” farmers benefited from dubious land grants by military governments, and that the traditional ruling parties are discredited. Because Bolivians have earned little from their mineral wealth, it is easy to whip up opposition to foreign oil and gas companies. It is true, too, that through Mr Morales's party and another left-wing movement, indigenous Bolivians have for the first time been elected to Congress in significant numbers. But the events of the past month are far from having been a democratic rebellion.

Geography has allowed a few tens of thousands of protesters to hold an entire country to ransom, starving hospitals of food and fuel (see article). La Paz, the capital, is located in a ravine thousands of metres above sea level. Its communications with the rest of the country pass through El Alto, a slum city of 600,000 and the protesters' stronghold. Many in El Alto disagreed with the protests. But those who fail to turn out are fined or threatened, and many of those who do are paid.

Where does the money come from? Venezuela's populist president, Hugo Chávez, of whom Mr Morales is a disciple? Perhaps, though there is no proof. The drug trade? Maybe. European NGOs? Probably, in some cases. Their well-meaning donors would be horrified if they knew their money was helping to establish an ultra-left dictatorship in Bolivia. For the radicals who have El Alto in their grip, Mr Morales and the European NGOs are “useful idiots”, in Lenin's phrase.

The poorest have suffered most from the blockades, and would suffer again from nationalisation. Inefficient state oil and mining companies stoked the hyperinflation of the early 1980s. Only since privatisation has Bolivia discovered enormous gas reserves. Exploiting these and taxing their foreign operators is the best way for Bolivia to leave poverty behind.

Let the real people speak

The election may restore some sense. All the signs are that it is not Mr Morales, still less those to his left, who speak for the majority. Most Bolivians, fed up with the blockades, are likely to support moderate figures. The new government should uphold the law and keep the roads open. As for that continental rebellion against the Washington consensus, it is largely confined to Venezuela, where high oil prices have let Mr Chávez defy the laws of economics. Elsewhere, Latin America's poor are too busy trying to earn a living to indulge such fantasies.

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Letters

Jun 16th 2005
From Economist.com

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

The state of France

SIR – Given the situation of the French economy, and the current perception of France as a second-rate power with first-rate arrogance, there is little question that Dominique de Villepin is the worst choice imaginable as prime minister ("Dominique to the rescue", June 4th). While brilliant, cocksure and a good speaker of English, he smacks of the same "we-know-what's-good-for-you" aristocratic leadership that doomed the EU constitution in the first place. French voters are angry about their prospects, their loss of station in the world and their leadership. The problem is that their leaders refuse to make the harsh choices needed to bring market reforms to a stagnant economy and revive labour-market liberalisation. These choices get harder each day they are not made.

Richard Quodomine
Paris

SIR – It has all happened before ("The Europe that died", June 4th). In 1954, the French parliament in effect abandoned the first post-war "European" constitution in its rejection of the European Defence Community. Yet ten months later, the establishment of the European common market, which was the beginning of today's European Union, was put forward at the Messina conference in Italy. Likewise, the rejection of the European constitution by the French (and Dutch) voters might be a highly positive event that could usher in a period of further dynamic integration, whereby European leaders would finally fix limits on where "Europe" is geographically and decide what kind of union they want.

Keith Crawford
Prague

SIR – It is hard to argue with your assessment of Jacques Chirac, a man who never met a striker he didn't like ("It's Chirac, stupid", June 4th). But even if labour market rigidities keep unemployment high, France will never have a Thatcherite revolution. Nor is it as necessary as you pretend. In spite of occasional strikes, public services are among the best in the world, whether trains, hospitals or schools. A quarter century after the arrival of the Iron Lady, can Britain say the same? This may explain why so many Britons vote with their feet and move to France each year. Would the last one to leave the island please turn off the lights?

STEPHEN THOMSEN
Saint Crepin, France

SIR – The question asked to French voters in the recent referendum was "Do you approve of the treaty establishing a constitution for Europe?" It is a mystery how *The Economist* can answer that question by saying that Mr Chirac must go. The absolutely worst thing he could do now is to give in to pressure and resign—if he did it would set a precedent that would signal the death of direct democracy, as we could no longer be sure on which issues voters are responding to. Referendums are too important to be hijacked by populists who can't wait until the next election to boot a politician out of office.

Boye Bjerkholt
Oslo

The Bank's expertise

SIR – You applaud the World Bank's shift into political territory, such as governance, law and public administration ("A regime changes", June 4th). I am not so sure. The other side of the move into politics is a retreat from more directly productive activities. The experts in roads, railways, electricity grids, fibre-optic systems, irrigation, industrial technology, agricultural and industrial research centres and universities are mostly gone.

Since these are key ingredients of an economy capable of generating sustained economic growth, and since the markets for private finance and private advice are very imperfect in supplying them, there should be a role for multilateral development banks. The World Bank's retreat suggests that the G7 states, which in effect run the organisation, conceive of it as a modern version of the poorhouse, rather than as an agency to assist developing countries to catch up in mass living standards.

All the more reason for the member states of developing countries to concert their actions in order to direct the Bank's attention back to issues of technological upgrading in agriculture, industry and services and hire technical experts to help.

Robert Hunter Wade
London

Politics of the Daisy

SIR – The official name of our party is Democrazia è Libertà (Democracy Is Freedom)—"La Margherita" (the Daisy) is our electoral symbol ("Oopsadaisy!", May 28th). Moreover, it is wrong to assert that the Daisy has opted for a "semi-detached membership of the Union" [an alliance of Italy's centrist and left-wing parties] and that it "will run against" the centre-left in the proportional part of elections to the lower house. On the contrary, the Daisy's decision to present its symbol in the proportional part is a strategy aimed at maximising the capacity of the centre-left coalition and to intercept decisive swing voters from the disgruntled centre-right that may want to turn to the Daisy, as happened in recent local elections.

Michele Anzaldi
Chief Press Officer,
La Margherita
Rome

Andorra shows the way

SIR – President Pervez Musharraf of Pakistan has suggested offering the people of Kashmir "something between independence and autonomy, like self-governance" that would be "over-watched" by Pakistan, India and the Kashmiris themselves ("In from the cold", May 28th). The parties would do well to consider the model of Andorra, which maintained peace and autonomy as a co-principality of the Spanish Bishop of Urgell and (eventually) the head of the French state for over 700 years. Though now a sovereign democracy and member of the UN, it has retained the co-princes as its heads of state.

The coat of arms on the parliament building bears the following legend: "Behold: here are the arms of a neutral valley; there are kingdoms more noble by which they rejoice to be guarded. If individually they bless other people, Andorra, why should they not, joined, bring to you a golden age." Would that were true of Kashmir as well.

Michael Ticktin
Roosevelt, New Jersey

Christmas greetings

SIR – The debate over the proper place of religion in civil society has been taking place since the birth of America (Lexington, May 28th). Its seeming banishment is no more recent than forced acknowledgments, such as the addition of "one nation under God" to the pledge of allegiance, or "In God we trust" on paper money, both of which took place only in the 1950s. Moreover, Lexington should note that the greeting, "Happy Holidays", has been around for decades. Far from being "ghastly" it is a way in which gregarious Americans can share holiday cheer with those of indeterminate faith, or can wish others a pleasant interlude from Christmas to New Year. Lexington should also be aware that while some here will not be happy until the greeting is "Happy Birthday Jesus the Christ, my personal Lord and Saviour",

the common greeting is still “Merry Christmas”, never “Happy Christmas”.

Paul Bungert
Tampa, Florida

ONLINE ARTICLES

The following correspondence refers to articles published only online

The G8 and Africa

SIR - While the world is congratulating the G8 for their debt relief and how this will solve the plight of the poor, let's just return to reality for a moment and examine the generosity ("Agreeing on Africa, up to a point", Economist.com, June 9th). Why does someone forgive debt? It is because you won't ever get paid back anyway. And what do you do then? You make very sure that you don't lend to those people again. Consequently, instead of heralding a new wave of investment into these poorer countries, the debt-relief deal is far more likely to demonstrate that the rich are now about to turn their backs, cut the funds and in 50 years come back to talk to the survivors.

Peter Nelson

SIR - You refer to Americans as "stingy" when it comes to helping the poor world. Try factoring in our awful budget deficit, which has gone mostly toward employing poor overseas workers, lifting millions out of poverty.

Roger Arnold

Buttonwood on banks and the yield curve

SIR - "Bankers scratch their heads and worry" (Economist.com, June 7th) presents the traditional demand-side explanation of an inverted yield curve in the United States forecasting economic recession. That may well be true but there are new economic factors at play. There is a surplus of savings in European and Asian countries which is soaked up by US Treasuries. If central banks and other investors in these countries are sceptical about America's long-term economic prospects, then they will shift their investments towards the shorter-maturity Treasuries. This leads to a supply-side explanation of an inverted yield curve forecasting economic recession.

Arun Khanna

SIR - You intimate that an inverted yield curve threatens the economy through the ability of banks to "transform savings into lending". If only it were so. As banks and other financial institutions have "reinvented themselves", they have increasingly obtained funds for lending not from savings but from other monetary sources, such as repos and Federal Reserve borrowings. Quasi-government agencies, such as Fannie Mae and Freddie Mac, have sourced much of their substantial funds from international lenders, often other countries' central banks. In these cases, loanable funds are not allocated from savings but from newly issued money, created from nothing as it were. If an inverted yield curve squeezes this recklessly inflationary business model it may not be such a bad thing after all.

Greg Payne

...on European markets...

SIR - The European Union's path has always been one of two steps forward and one step back, yet the general direction is positive ("European Disunion", Economist.com, May 24th). Given that the French, Dutch and British are not supporting the constitution in its present form, it does not mean a reversal in the progress towards an integrated and thriving union. European nations are the best in the world at multilateral diplomacy, and relations between these nations are peaceful today. With the EU expanding, economic growth is being stimulated by the admission of new countries from the east. Failure to

implement the constitution is not a sign of the failure of the European project, but merely a temporary setback in the journey towards a more integrated, thriving political and economic block.

Mark Emanuelson

...on ultra-long bonds...

SIR - In "From here to eternity" (Economist.com, May 31st) you failed to mention explicitly the danger to bonds from the massive unfunded liabilities that all western governments face. The United States has somewhere between $30 trillion and $50 trillion in unfunded liabilities to make good on the promises of future Social Security and Medicare benefits to the baby boomers. European countries have the same problem. They will have to sell massive amounts of long bonds, driving the price way down and ending the 25-year bull market in government paper.

It should be interesting. I see massive defaults in the next decade.

David Champeau

...and on Berkshire Hathaway

SIR - The performance of Berkshire Hathaway relative to the S&P 500 speaks more to the value of sound corporate governance than it does to the detriment of efficient markets ("Still earning after all these years"). In an efficient market, a firm with poor management, weak vision and execution, or a disregard for shareholder value, will be accurately priced at a discount to a well-run firm. By taking large positions in his investments along with active, or at least influential, roles in them, Warren Buffett does what your everyday investor cannot: he actually adds value to the firm. It is this ability to change the course of a firm, not an efficient-market-defying stock picking strategy, that results in above-average returns. Of course, his part-time role pushing furniture, kitchen supplies and the rest doesn't hurt either.

Ryan Haugarth

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Iraq

Heroes wanted

Jun 16th 2005 | BAGHDAD, MOSUL, TAL AFAR AND TIKRIT
From The Economist print edition

AFP

Amid an explosion of insurgent violence, America pitches Iraqi forces into the fight

Get article background

BAHRO TAHIR is not the brightest soldier in Iraq's new army. Last week, at an American-assisted military academy in Tikrit, Saddam Hussein's home town, he began basic training for the fourth time. It was not that he wanted to spend another month studying tedious human-rights law and drilling under a blistering sun; Mr Tahir did not want to do that at all. Rather, according to the academy's Iraqi instructors, Iraqi army commanders tend to send to basic training only those too friendless or dim to wriggle out of it, which included Mr Tahir. “They said they were sending me here for a computer course,” he lamented, to the amusement of the recruits within ear-shot, except for another basic-training veteran, who turned out to be deaf.

The instructors had more pressing concerns than the quality of their recruits. Two months ago, Iraq's Ministry of Defence took over the job of paying its employees, up to then paid by America, and since then they had not seen a cent. Language is also a problem, with half the recruits speaking Arabic and the others Kurdish, and few instructors knowing both. Perhaps the worst problem is the quality of leadership. The Iraqi colonel nominally in charge of the academy tried to employ his relatives, said his American supervisors, including one who was subsequently arrested in murky circumstances. He would not have been the first insurgent to practise on the academy's range: after the fighting in Fallujah, last November, American marines found the academy's badges on enemy corpses. Asked to estimate how many of the academy's students were motivated by a desire to help their country, Major Donald McArdle, the American in charge, reckoned 5%; his colleagues thought this too high.

Senior American officials have made somewhat bolder claims for the Iraqi Security Forces (ISF), currently numbering 169,000 soldiers, paramilitaries and police. They are supposed, after all, to be America's exit strategy from a military intervention that has so far claimed nearly 1,700 American lives—and which, according to a poll released this week, six out of ten Americans now oppose (see article).

In recent weeks, ISF units have taken charge of small areas of Baghdad and Mosul. By the end of this

year, when elections are due to be held under a new constitution, they are supposed to number 230,000, and to be operating in divisions. America would withdraw, or so officials say, some troops early next year.

That is a pipedream. Corrupt, patchily trained and equipped, often abysmally led and devoid of confidence, most army units cannot operate above platoon-size. Between Iraqis and Americans there is deep mistrust: Iraqi units billeted on American bases are fenced off from their hosts as a security measure.

For every vaunted ISF success, examples of cowardice and incompetence abound. Even when stiffened by American forces, the ISF often flee when under attack. Iraqi marksmen have a habit of closing their eyes and spraying bullets in “death-blossoms”, in GI slang. Some of the better units, including the 12-battalion, mostly Shia, police commandos, are accused of torture and sectarian violence.

Sleeping partner

Not that most American commanders—many of whom are on their second or third tour of Iraq, and want it to be their last—admit these deficiencies. To “put an Iraqi face” on operations, they are often accompanied by an Iraqi counterpart. But during operations observed by this correspondent in the violent northern town of Tal Afar last week, the “Iraqi face”, that of a genial Kurdish general, spent much time with its eyes closed, gently dozing.

And yet and yet. Given that only a single American-trained Iraqi battalion existed a year ago, there has been a lot of progress. Desertion rates among the ISF, chronic last year when whole battalions hotfooted it, are currently low. With better leadership—if this could only be found—about 40% of army and paramilitary battalions are thought to be close to operating with minimal American support, and another 25% are only six months behind. Within 12-18 months, it is said, these units should be operating independently.

Furnishing them with the necessary headquarters and support units will take longer. As will the training of the police. Self-belief is likely to emerge only under an effective Iraqi government, which could still be a year away, or more. Top American officers in Iraq say that the United States should not contemplate making significant troop withdrawals for at least two years, perhaps longer.

A recent night-time raid with Iraqi soldiers and police commandos in Khalis, a mostly Sunni district north of Baghdad, illustrated both progress and shortcomings. The Iraqi officers were stirred to issue orders to move only on learning that their American mentors—part of a new scheme to embed 10,000 American troops in the ISF—were on the way. The orders then sparked terror in the ranks. Soldiers asked to be excused from the mission, complaining of sore limbs or faulty weapons. Many took sedatives, which Iraqi troops use to control their panic. “Better they take drugs than run away,” an Iraqi officer explained. “Most of these guys haven't had much military experience or training and the insurgents are ferocious.”

Having encircled the first target-house, the stoned warriors charged, firing their Kalashnikov assault rifles into the night sky. Inside the house, they grabbed two youths and shot a third in the shoulder as he tried to escape. They then ransacked every room, found a video camera and several cassettes and threatened the prisoners with summary execution. The youths admitted to having filmed insurgent attacks. Both were soldiers of the old regime and former residents of Fallujah. The injured prisoner received no medical attention as the ISF rampaged on to the next target.

The billowing violence

No wonder they were scared. The past two months have seen a staggering explosion in violence, even by Iraq's standards. Over 1,000 people have been killed, mostly by some 160 suicide bombers. On June 14th, a suicide bomber killed 22 people and injured more than 80 in Kirkuk, an oil-rich city disputed between Kurds and Arabs. Throughout this week, dozens of bodies of soldiers and government contractors were found littered across western Iraq, most of them shot in the head.

So much for the notion that Iraq's elections in January had quelled the insurgency—a delusion to which some American officials are still prone. “I think everyone understands that it's getting better every day,” said Lieutenant-Colonel Michael Gibler last week in Mosul, which was hit by over 30 suicide bombers in April and early May. “Of course, every nation that's got IEDs [improvised explosive devices] and drive-by shootings and suicide bombers has definitely got some security issues, and this country has got those. But we're working to change that.” The colonel received a phone call minutes later, informing him that four of his men had been injured by a suicide bomber.

To be sure, there are some small causes for hope amid the savagery. Since the elections—in which few of the Sunni Arabs who dominate the insurgency voted—Sunni religious and political leaders have held talks with American and Iraqi officials, and some have indicated that they will support the next election. This week, the national security minister announced a plan to offer amnesty to some insurgents, in an effort to separate those Sunnis who merely fear being marginalised by the Shia majority from dead-end Islamist fanatics. Yet it is not clear what influence, if any, the Sunni leaders could wield over their divided people. Worryingly, members of the National Dialogue Council, a Sunni group negotiating to bring their community into the political process, this week rejected an offer of 15 seats on a committee formed to draft the country's new constitution.

The fact is that many more Sunni Arabs would have voted in the last election had they not been too afraid to do so. Their areas are no more secure now. Indeed, parts of Anbar province, the Sunni heartland, appear to be sliding deeper into war.

AFP

Soldier and suspects

Several small towns, including al-Qaim and Haditha, are in effect held by insurgents—despite an American air assault on the former last month, which followed a firefight in which the marines were briefly outgunned. Even in Fallujah, the symbol of America's refusal to deny the insurgents sanctuary, they are said to have re-established a hold. Last month, Anbar's governor was killed after American troops attacked a house where he was being held hostage and ignited a stockpile of arms.

Eye for an eye

Meanwhile sectarian violence is rising. For two years, Shia pilgrims have been murdered on the road between Baghdad and the holy cities of Najaf and Karbala. Recently, in defiance of an edict by Grand Ayatollah Ali al-Sistani, the most influential Shia cleric, Shia militiamen have taken reprisals. Last month, 14 Sunni clerics were murdered, sparking a wave of tit-for-tat sectarian murders in

Baghdad's slums. In the district of al-Bayaa, two men were shot dead in a photography shop prominently displaying a picture of Mr Sistani. “If the government does not find the killers, I will solve the problem myself,” vowed the brother of the two men, arguing that Mr Sistani's edict forbids acts of random violence, but not rightful vengeance.

While lawlessness and insurgency endure, so will low-level sectarian killing. But few Iraqi commentators predict civil war anytime soon. The Sunnis are too fractured, and the Shia leaders, secure in their democratic majority, have no wish for it. On May 28th, Muqtada al-Sadr, a hitherto bellicose Shia leader, brokered talks between Sunni clerics and the Shia leaders of the Badr Brigade, a militia accused of killing the clerics. American officials in Iraq were relieved, but still wished Mr Sadr would stop using the American and Israeli national flags as doormats outside his mosque in Baghdad.

And then there are the *jihadis*. In Tal Afar last month, a Lebanese youth with his hands taped to the steering-wheel of a Chevrolet saloon drove a bomb into a funeral procession, killing 25 mourners. Two more suicide bombers then struck the town, killing 35. These death tolls were unremarkable, but the victims were not. They seem to have been selected merely for being members of two tribes, the Sada and the Jolak, who are the (wholly secular) rivals of another tribe, the Qarabash, which happens to be on good terms with the local Islamists. In Iraq these days, it seems, a suicide bomber can be had for the asking.

Who would die so wantonly? It beats American intelligence officers. Asked about Abu Musab al-Zarqawi, a notorious—and, according to some reports, one-legged—Jordanian fanatic, a senior American official admitted, “We don't even know how many legs he's got.”

Until recently, it was said that all the paradise-seekers were foreigners: that Iraqis didn't do suicide bombing. This is probably still largely true. In the rare case that a bomber's nationality is established, it is usually foreign. Saudi, Palestinian, Yemeni, Syrian and Jordanian bombers have been identified. Most of them probably entered the country from Syria. But with Iraq's own Islamists becoming increasingly radicalised amid the mayhem, a growing minority of suicide bombers appear to be homegrown. Several would-be Iraqi bombers were recently arrested in Mosul. Most were middle-class university students, though, according to the American soldiers who shot and arrested her, one was a middle-aged woman.

Iraq's own Islamist terrorists?

Strategically, this is a disaster for America. An Iraq refashioned in its image was supposed to persuade angry Arabs of the joys of liberal democracy. Yet the country is now breeding Islamist terrorists of its own. Having no objective but to destroy Americans and the Iraqi government they have helped to create, they will not stop their attacks until American troops quit Iraq, or possibly even after then.

Tactically, for American troops, the suicide bombers are more manageable. Rarely have they penetrated American armour, with many American casualties the result of IEDs, which are much more numerous. Not so for the ISF, however, who drive around in soft-skinned pick-up trucks; 270 Iraqi soldiers and police were killed in May, mostly by suicide bombers. On June 15th, a suicide bomber wearing an Iraqi uniform killed at least 23 people and injured 29 in an army mess hall in Khalis.

In fact, even without killing Americans, the suicide bombers are scoring hits by ensuring that American troops remain deplorably trigger-happy, firing on many innocent motorists, and so creating more insurgents. In eastern Mosul alone, around five such incidents are reported each month. On June 14th, American marines killed five unarmed civilians after firing on two cars at a checkpoint in Ramadi, having been attacked by a suicide bomber moments before.

In fairness, some American fighters are striving to develop a softer touch. On patrol in Mosul last week, soldiers dropped by shops to ask the locals how they were doing. But, running hunched from shop to shop, rifle at the shoulder, their faces hidden by helmets and mirrored shades, they remained an intimidating sight. One shopkeeper politely asked them not to come again during the day as they were scaring away his customers.

And yet Mosulis, like most Iraqis, do now seem more willing to co-operate with their occupiers. Last year, a hotline for Iraqis to call in with information about the insurgency received barely 100 calls a month. Since the election, it has been receiving 300-400 calls, leading to the killing or capture of several mid-level insurgents.

The impression that there is still hope for America's forces in Iraq is reinforced farther west, towards the border with Syria, in Ninewa province. American hawks have accused Syria of flooding insurgents across this border, though it is hard to tell how they know this: until recently, America had deployed only 450 combat troops to police 200 miles (320km) of unfenced border and dozens of hostile towns, including Tal Afar, a place of 250,000 people, which saw a full-scale battle between American troops and insurgents last year.

In April, when a 4,000-strong American cavalry regiment was hastily sent to the area, it found virtually every town in insurgent hands, and Tal Afar a ghost-town. Shops were shuttered, schools were closed and the town's hospital was filled with wounded insurgents. Tal Afar's 200 policemen were besieged in an Ottoman fortress; the town's mayor, being alive, was assumed by the Americans to be an insurgent sympathiser.

Getty Images

The Iraqi army's vulnerable version of a tank

Since then, the soldiers have set about proving a simple truth: where American troop numbers are increased, security improves. Columns of Abrams tanks and Bradley fighting vehicles now patrol Tal Afar's bomb-blasted streets. On its previous deployment, to Anbar, the regiment made many of the mistakes common to American forces in Iraq, admits its thoughtful commander, Colonel H.R. McMaster. These included the tendency to arrest military-age males indiscriminately. In Tal Afar, it is acting according to the intelligence it receives. As a result better intelligence is forthcoming. On a foot-patrol with the regiment in Tal Afar last week, half a dozen people offered information on the insurgents terrorising them. On the strength of one such tip-off the day before, 28 carefully identified suspects were surgically seized.

Wanted: more Americans

Such operations are impressive, but they only confirm what every American soldier in Iraq knows full well: there are far too few of them to secure the place. Even the regiment in Tal Afar is hard-pressed. Though it was sent, in part, to police the border with Syria, it can spare only 300 soldiers to the crossing-point at Rabiya. The unit's commander said they might be able to slow the flow of arms, but expected them to have no impact on the numbers of suicide bombers entering the country.

Moreover, while the cavalrymen rode north, gaps opened behind them. They were previously charged with securing Baghdad's southern approaches, including the towns of Mahmudiya, Latifiya and Iskandariya, an area riven with sectarian violence. They were replaced by a much smaller force, an exercise in futility, elegantly described by one commentator as “ironing the wrinkle around the shirt.”

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The war on terror

That not-winning feeling

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From The Economist print edition

Eyevine

Public opinion is turning against the war in Iraq. How significant is this?

Get article background

THE war in Iraq has usually made comparisons with Vietnam look foolish. When it began, the word “quagmire” was barely out of critics' mouths before American troops were marching confidently into Baghdad.

Now the Vietnam analogy is returning to haunt debate once again. Between one-third of Americans (in a poll by the Pew Research Centre) and almost half (in one for ABC) say Iraq will turn out to be another Vietnam. That is less than those who think America will avoid a quagmire, but a lot more than last year, when people decisively rejected the Vietnam analogy.

These lurid fears reflect a genuine turn in public opinion. This week, a Gallup poll found that 56% of people said it was not worth going to war—the lowest level of support since the invasion in 2003. Disapproval rates for President George Bush's conduct of the war have reached new peaks. The Pew survey found that almost as many people want troops to come home as want them to stay until the situation stabilises (46% to 50%: a tie, given the margin of error). For the first time, more than half the population thinks the war has not contributed to American security.

It is possible to claim—as the administration does—that these trends do not amount to a decisive turn in public opinion against the war. People are uneasy, the argument goes, but not defeatist. Their unease causes their views to fluctuate wildly in response to short-lived bad news.

There is some truth to this. Seventy-seven Americans were killed in May, making it the fifth deadliest month since war began in March 2003. But if news from the front should start to improve, opinion will change rapidly.

The administration itself has probably worsened public unease with its own optimism. Mr Bush hailed the election in Iraq as “a great and historic achievement”, which it was, but said rather less about the problems the new government would inherit. When civilian casualties soared, reaction set in. The president may perhaps be forgiven for his comment, but there seems little excuse for the remark at the

end of May (a time of massive car bombs) by the vice-president, Dick Cheney, that the insurgency was in its “last throes”. The administration's pattern of overselling achievements—remember “Mission accomplished”?—has probably made public opinion more nervous and volatile than it would otherwise be.

Arguments over the mistreatment of prisoners in Guantánamo Bay may have further depressed opinion by raising questions about the essential rightness of America's behaviour in the war on terror. In late May, the secretary-general of Amnesty International compared the detention centre in Cuba with a Soviet gulag. Mr Bush called the analogy “absurd” (which it was: the gulags were essential to the operation of the Soviet state). But the charge still caused something of a rift in the Republican coalition.

Mr Cheney said there was no plan to close the camp and insisted that “the important thing to understand is that the [prisoners] are bad people.” But two Republican senators, Chuck Hagel of Nebraska and Mel Martinez of Florida, both argued that the facility may be more trouble than it is worth. Mr Martinez's comment (“At some point you wonder about the cost-benefit ratio”) is especially striking considering his background: he was a member of the administration, and ran for the Senate with the encouragement of the White House. He is no Republican maverick wandering about off the reservation.

Stories of prisoner abuse would really make a difference, though, if they significantly dented Americans' image of themselves as the good guys abroad. So far, they have not done that. By a wide margin, people believe the reports are isolated incidents, not part of a wider pattern. This division is partisan. Liberal Democrats believe there is a wider pattern; everyone else thinks they are isolated incidents.

So it is notable that while a clear majority is worried about the war, Americans are more evenly split on whether it was the right thing to do in the first place. Even now, slightly more people think the decision was right than wrong (though the majority is dwindling). That suggests there are reservoirs of support.

The administration can further claim that, despite all the wobbles, people essentially made up their minds about Iraq during the election campaign last year, and have not changed them since. The Pew poll provides intriguing evidence that this may be true. The centre asked respondents whether they were more or less emotionally involved in news about the war. The number of those saying they feel less involved has risen sharply. The turn in opinion is taking place in people's heads, not their hearts.

Lastly, the decline in support could be explained away as part of a wider outbreak of second-term blues. The president's job-approval ratings are miserable. Congress's are worse. The best indicator of political chirpiness—the question, “Do you think things are on the right or wrong track?”—is far below what it was after September 11th or during most of the late 1990s. Opinion on Iraq reflects, as well as contributes to, the malaise.

For all these reasons, it seems unlikely that the change in public opinion will cause any fundamental reappraisal of the administration's Iraq policy. And, of course, that would be extremely unlikely anyway. Mr Bush has staked his presidency on success in Iraq. It would take a huge backlash to force him to accept anything that smacks of failure or defeat, and the decline in public support is nowhere near strong enough to make him contemplate such a course.

But if the White House thinks this situation is sustainable—that it ploughs steadily on while public support bounces around—it is taking a big risk. Yes, opinion on Iraq bobbles around each month. But, argues Christopher Gelpi, a professor at Duke University, the most important single factor determining the level of support is Americans' belief that they are winning. As long as they think they are, they will accept heavy casualties, and even discount torture as part of the price that must be paid.

This was true in Vietnam: opinion did not turn against that war until the Tet offensive in 1968, which was seen by the public as a defeat. Iraq has followed suit.

America's death toll passed 1,000 last September, and this received a lot of coverage in the country. November was the bloodiest month since the war began, with a spate of insurgent attacks. Yet during this period, support for the Iraq policy rose slightly—because Americans were looking ahead to the elections in January and believed their country was making progress towards that goal, despite the level of violence. This summer, the pattern has been the opposite. Iraq seems to be in political stalemate, nobody knows how to bring the Sunnis into the constitutional process—and support has fallen, even though the American death rate is lower than it was a few months earlier.

All this points to two dangers for the administration. First, by overselling the progress it has made, it risks reducing voters' patience in the face of inevitable setbacks. Second (and most important), public

support depends critically on progress actually being made—which at the moment, it does not seem to be.

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Celebrity trials

Not Bad, but not quite Good

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Reuters

A wholesale acquittal for the faded King of Pop

ON JUNE 13th, in the small town of Santa Maria, a Californian jury acquitted a (waning) global pop superstar on ten counts of child molestation, “administering an intoxicating agent”—ie, wine—to a minor and conspiracy to “commit child abduction, false imprisonment and extortion”. Had they found Michael Jackson guilty, he could have faced more than 18 years in prison. Instead he returned, a wan but free man, to the Peter Pan-fantasy world of his Neverland Ranch.

Did celebrity confer immunity? Plenty of America's cable TV pundits seemed to think so. Their common wisdom is that O.J. Simpson, a former football star, “got away with murder” in his trial ten years ago, and that so, too, did Robert Blake, a film and TV actor acquitted in March of murdering his wife. Doubtless they will say the same if Phil Spector, an iconic music producer, is acquitted when he goes on trial later this year accused of killing Lana Clarkson, a B-movie actress.

They have a point. The rich and famous can hire the best lawyers, employ their own investigators and exploit the media to their advantage. All this applied in the Jackson case. The star's lead lawyer, Thomas Mesereau, hired a top private investigator to uncover the tawdry, gold-digging past of Janet Arvizo, the mother of Mr Jackson's alleged victim, destroy her credibility, and cast doubt on the motives of the other prosecution witnesses.

But the underlying reason for the jury's verdict was also, in part, the ineptitude of the prosecution, led by the Santa Barbara County district attorney, Thomas Sneddon. By accusing Mr Jackson of conspiring to abduct the Arvizo family, allegedly to Brazil, Mr Sneddon not only brought a charge that was difficult to prove, but also allowed Mr Mesereau to attack Mrs Arvizo for her dubious past.

In theory, Mr Jackson's reputation should have been cleared. The four-month trial took place in a conservative, un-Hollywoody part of California; the jurors, eight women and four men, seemed eminently sensible; and, in contrast to the O.J. Simpson case, the trial was not televised and no race card was played (though Mr Jackson did tell Jesse Jackson in a March radio interview that he drew inspiration from the travails of Nelson Mandela, Muhammad Ali, Jesse Owens and so on).

In practice, after an ordeal that began with his arrest in November 2003, Mr Jackson's reputation is

perhaps more stained than ever. The world now knows of paedophilia allegations, and big pay-offs to settle them, that go back to 1990. It knows that the entertainer buys pornographic magazines; that a pet chimpanzee used to use his toilet and “help me clean the room”; and that he is $270m in debt. Moreover, at least one juror has said that Mr Jackson probably is a child-molester—but not, in this case, beyond a reasonable doubt.

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Reducing the nuclear threat

Still the stuff of nightmares

Jun 16th 2005
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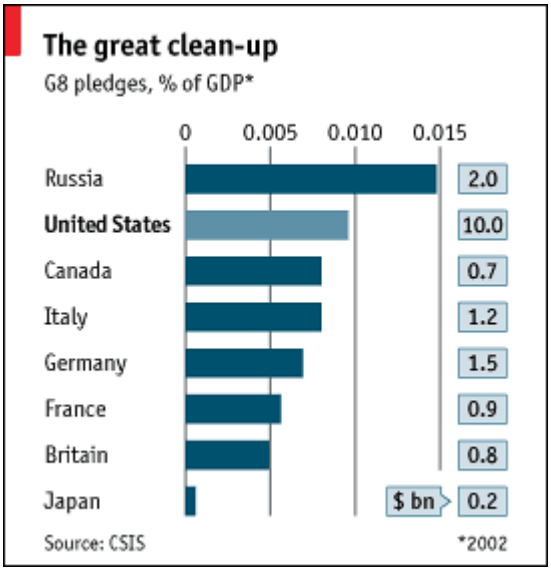
Securing Russia's loose nukes



Get article background

WHEN first proposed, the plan was as controversial as it was visionary. In 1991, as the cold war ended, Senators Sam Nunn and Richard Lugar persuaded Congress to enhance America's own safety by helping to secure the vast archipelago of nuclear, chemical and biological dumps dotted across Russia and the former Soviet Union. Three years ago, the Bush administration persuaded its G8 partners (the other G7 rich nations, plus Russia) to take up the cause: between them they pledged $20 billion over ten years to secure Russia's remaining “loose nukes” and the rest. But as another G8 summit looms next month, at Gleneagles in Scotland, Messrs Nunn and Lugar would probably give the summiteers barely a passing grade.

The sense of urgency about the nuclear clean-up that followed the September 11th attacks has dissipated. Three years on, of the $20 billion promised ($10 billion of it by America), the fund is still almost $3 billion short; yet the original pledge was meant to be a floor, not a ceiling. Meanwhile, the tasks mount up. Congress has allowed funds to be drawn away to cope with dangerous weapons caches in other countries; Albania (where some chemical weapons are being destroyed) and Libya are two recent beneficiaries.

The world, Mr Nunn points out, is in a race between the co-operation needed to lock down dangerous weapons materials and the catastrophe that would follow if terrorists managed to get their hands on some sort of bomb. Last month, NATO parliamentarians were treated to the likely consequences of failure in an exercise called “Black Dawn”, sponsored by two Washington-based organisations, the Nuclear Threat Initiative and the Centre for Strategic and International Studies. Their scenario: a terrorist network steals highly enriched uranium (HEU) of the sort used in often poorly guarded civilian research reactors and then detonates a bomb.

Its plausibility had already prompted the Bush administration last year to set aside $450m over nine years to ship back Russian-origin HEU from similar research reactors. More than 100kg of the stuff has already been returned, largely at America's expense, from Serbia, Romania, Bulgaria, Libya, Uzbekistan, the Czech Republic and Latvia. Spent fuel is also to be repatriated. And work has started to convert other

such reactors (there are some 130 worldwide) to run on less weapons-usable low-enriched uranium. Meanwhile, under a separate, accelerated deal due for completion in 2013, about half of 500 tons of Russia's surplus HEU (enough for 30,000 weapons) has already been blended down for safer commercial use.

Yet not all is going swimmingly with other projects in Russia. By this autumn, the Department of Energy expects to have properly secured 77% of all Russian sites where weapons-usable nuclear material is stored (the job is meant to be completed by 2008). But the bulk of the dangerous stuff is in the remaining sites, including four where weapons work continues and where Russian officials have slammed the door to help from outsiders.

For their part, American negotiators have also been holding out for tough liability rules to govern future co-operation in Russia. The row has already set back by a year implementation of another agreement under which America and Russia will each dispose of 34 tonnes of plutonium (another bomb ingredient) by turning it into less vulnerable mixed-oxide reactor fuel.

When they met in Bratislava in February, George Bush and Russia's Vladimir Putin agreed to speed things up. America is preparing to compromise over liability. Will Mr Putin knock heads together in Russia's security service, which has been most hostile to letting foreigners into sensitive nuclear sites?

Russian officials fume at the notion that they cannot handle their own security. And Mr Putin would rather the outside world put more of its cash elsewhere: into disposing of Russia's vast stockpile of chemical weapons and into dismantling decommissioned, and in some cases leaking, nuclear submarines that pose an environmental hazard in the Arctic and at naval bases in Russia's far east.

The question is one of priorities. To avoid causing offence, Messrs Nunn and Lugar are keen that America and Russia work on the clean-up effort as full partners. But it is the nuclear threat that gives them nightmares.

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Atoning for segregation

Justice delayed

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After decades, the Senate at last says sorry for part of it

AP

Till's mother mourns

DORIA DEE JOHNSON sounds reverential when she describes her great-great grandfather, Anthony Crawford. A successful black farmer, he owned over 420 acres of land and had 13 children. He was also lynched—beaten and hung from a tree—in Abbeville, South Carolina, in 1916 after an argument with a white storekeeper. The land was confiscated and the family was forced to move. On June 13th, when the Senate formally apologised for failing to create a federal anti-lynching law, Ms Johnson was in the chamber with some 160 members of her family to witness what she had fought for. “It's a first step towards healing,” she said.

From 1882 to 1968, 4,743 people, 3,446 of them black, were killed by lynch mobs, according to Tuskegee University records. The actual number was probably much higher. While many assume such acts were rare outbursts by bloodthirsty vigilantes, lynching was fairly socially acceptable, mostly in the South, though it occurred in all but four states. In “Without Sanctuary: Lynching Photography in America”, a book by James Allen that inspired two southern senators to propose the apology, what is striking is not so much the mangled bodies hanging from ropes, but also the crowds that surround them. Not a few victims swing in crowded town squares, with families and civic leaders looking on. A number of the images are actually souvenir postcards.

Though states rarely prosecuted white men for killing blacks, there was never a federal law against lynching. Nearly 200 pieces of anti-lynching legislation were proposed, with support from seven different presidents, and three anti-lynching bills made it through the House. But each time a bill was introduced in the Senate, southern conservatives used their filibuster powers to defend states' rights. “Nobody even talks about this period of history because there's so much shame in it,” says Mark Planning, counsel for the Committee for a Formal Apology, a group that lobbied the Senate. Lynching, he says, was simply a way of intimidating blacks (particularly “uppity” ones) that was collectively overlooked for decades.

The apology came on the same day, June 13th, that saw the beginning of jury selection for the new trial of Edgar Ray Killen, a reputed Klansman charged with murdering three civil-rights workers in Neshoba County, Mississippi, in 1964, where they were registering blacks to vote. The case, which helped galvanise the civil-rights movement and inspired the film “Mississippi Burning”, has remained unsolved for decades. Mr Killen, a Baptist pastor, now 80 and in a wheelchair, was indicted in January.

June also saw a belated autopsy of the body of Emmett Till, a black 14-year-old Chicagoan who was brutally killed in Mississippi in 1955 after he allegedly whistled at a white woman. Months after his killers, Roy Bryant and J.W. Milam, had been swiftly acquitted by an all-white, all-male jury, they admitted their guilt in graphic detail in an interview for *Look* magazine, given to pay their legal fees.

Till's case brought the extreme violence of the racist South to light mainly because his mother, Mamie Till Mobley, decided to put his bloated, unrecognisable body on view in an open coffin and let *Jet* magazine, with its mostly black readers, photograph him. “Let the people see what I have seen,” she said. The Department of Justice is working with the Mississippi district attorney's office to find out whether any prosecutions remain possible, though Bryant and Milam are both dead. There is good reason, says Alvin Sykes of the Emmett Till Justice Campaign, why there is no statute of limitations on murder. No amount of evidence at the original trial would have convicted white men for murdering a black boy.

Many argue that the country is obliged to look at these cases before it can move forward, particularly in the Deep South. But these are probably the last of the landmark civil-rights trials. Since 1989, 23 murders have been re-examined in the South, resulting in 27 arrests, 21 convictions, two acquittals and one mistrial, according to the Southern Poverty Law Centre. These so-called “atonement” trials show that justice will be served, even if it takes four or five decades. But the prospect of financial compensation, as for Anthony Crawford's lost land, is remote. Ironically, this may be because many black sufferings were too awful for any price-tag.

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The Archdiocese of Boston

The church's tin ears

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A parishioners' revolution makes church leaders backtrack

Get article background

GIVEN all that has gone before, this was hardly the image the Archdiocese of Boston needed the world to see: small children crying piteously about what their church had done to them. Just two days before, their Catholic elementary school was due to close for good; the locks were changed, graduation ceremonies were cancelled, and the beloved classroom fish were trapped inside. What an error.

Parishioners these days are very different from the meek flocks of a generation ago. They now have few qualms about organising a revolt. When church leaders announced that they would close Our Lady of the Presentation School and use it to house a tribunal that rules on marriage annulments, the children's parents made no secret of their dismay. They offered to buy the school at market value and turn it into a community centre. When the church demurred, and then closed the school, they vowed to fight. Parents launched round-the-clock protests outside the school, setting up tents in a nearby park. The locked doors had been a disastrous pre-emptive strike: the archdiocese had feared that the parents were going to occupy the school.

The result was another paranoid week for church leaders, still reeling three years after the sex-abuse scandal tore a public rift between them and lay Catholics. After paying massive settlements to victims of clerical sex abuse, the archdiocese found itself in financial crisis. So it announced last year that it would close 83 parishes and sell the properties to raise cash.

Many lay people grudgingly accepted the news. But at St Albert the Great, a vibrant parish in a suburb south of Boston, parishioners occupied their church. Eight other parishes eventually followed suit: for months now, people have been sleeping in pews, organising their own Masses—and comparing church leaders to Judas. Some parishioners have sued the archdiocese, arguing that church buildings belong to local Catholics, not to their leaders.

The occupations put the archdiocese in an impossible position: it knows better than to yank people out of their churches by force. Yet Archbishop Sean O'Malley and his lieutenants do have astoundingly tin ears for publicity. Some protests might have been averted completely if church leaders had shown the tiniest personal touch. Instead, they announced which parishes would close by way of Federal Express packages. Parents of children at Our Lady of the Presentation School complained that they were denied an audience with the archbishop, no matter how often they asked. “They're just so disconnected,” said one parent last week. “They are in such a bunker that they have lost grasp of what it means to be in society, to be a good neighbour, to be a good Christian and Catholic.”

But at least they are able, from time to time, to figure out when they have to cut their losses. When the vigil at St Albert the Great had gone on for 215 days, the archdiocese announced that the church would stay open after all. And this week, after several days of awful press about the school closings, Archbishop O'Malley agreed to meet the parents and reconsider their proposal. After a discussion, which one mother described as businesslike, the archbishop tentatively agreed to sell the school to them. He also let the children back inside to retrieve their artwork and their fish, thankfully still alive.

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Methamphetamine

Instant pleasure, instant ageing

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The awful effects of an increasingly popular drug

VISITORS to a county court in Salt Lake City, Utah, are shown photographs of a woman in her late 20s who has been arrested several times for dealing in methamphetamine, a notoriously addictive and increasingly common street drug. She used the drug herself, and the photos show her ageing some 30 years over a five-year period: cheeks sinking, eyes turning glassy, teeth rotting.

Utah proves methamphetamine's awful power. This predominantly Mormon state largely eschews coffee, tobacco and alcohol. But it ranks third nationally in the percentage of arrested men who tested positive for meth, and meth-related crimes are said to account for perhaps 80% of the criminal activity in the state.

The story is repeated nationwide. Methamphetamine—also known as ice, crank, crystal or glass—is, in the eyes of many, America's leading drug problem. Limited to California and the Pacific north-west a decade ago, it has now spread everywhere. In Missouri, 2,000 meth labs were discovered last year. Atlanta has become the gateway for meth distribution across much of the east coast, with 174 lb (79 kg) being seized in one raid in March. And in Florida, a wave of meth-taking among homosexuals is thought to be behind an increase in HIV: meth makes people engage in more sex, more carelessly.

Methamphetamine can be made with a handful of ingredients—pseudoephedrine (a common ingredient in many cold remedies), red phosphorus, muriatic acid, fertiliser, iodine. Recipes are widely found on the internet. A day's work in a kitchen can yield a dozen doses. Injected or smoked, methamphetamine works almost instantly on the brain, releasing far more dopamines, the brain's primary pleasure-transmitters, than cocaine or heroin. Users feel intense pleasure, followed by an energetic high that can last for days. Addiction may follow a single dose.

Meth's toll is appalling. The rotten teeth of a “meth mouth” are common in heavy users, a byproduct of its effects on the metabolic system, plus the huge quantities of sugary soft drinks consumed to alleviate the dry mouth caused by the drug. Methamphetamine drastically alters the brain, shrinking it 1% a year with heavy use.

John Hoffmeister, a policeman in Salem, Oregon, says that his officers find children of meth addicts who are unfed, living amid garbage, their parents too “tweaked” to provide minimal care. So far this year they have placed 129 children in foster homes after their parents were arrested for meth-related crimes—a huge number in a city of 120,000 people.

In late May federal and local police in Salem busted a nearby meth “superlab”, run by Mexican nationals, that was able to turn out 90lb of meth in two or three days, enough for 400,000 jolting doses. Big labs like this were common until recently, when restrictions on the sale of medicines containing pseudoephedrine slashed their numbers. Oklahoma, Illinois, Missouri, California and several other states are limiting the sale of cold cures; Oregon is discussing a complete ban.

But new restrictions have driven meth manufacture into Mexico. There labs produce hundreds of pounds of meth a year and smuggle it into the United States, where its near 100% purity commands premium prices. Earlier this month the *Oregonian*, a newspaper in Portland, reported that Mexico is importing 224 tons of pseudoephedrine a year, though, according to the paper, it legitimately needs only 130 tons of the ingredient.

Mexican officials are trying to stem the flow, but that just pushes production south again. Argentina and Colombia now seem to be importing unusual quantities of pseudoephedrine, say officials with the Drug

Enforcement Administration.

Yet, despite the evident dangers of increased methamphetamine use, the federal government's anti-drug focus is once again on marijuana. Newspaper advertisements are warning teenagers that marijuana users risk depression, suicidal tendencies and schizophrenia. But Mitch Earleywine, a psychology professor at the University of Southern California, thinks the campaign may backfire once teenagers see little evidence that marijuana causes such things. “We lose credibility,” he says. “Then we tell them that meth causes your brain to shrink—which it really does—and they don't believe that, either.”

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Judges' salaries

Senator, can you spare a dime?

Jun 16th 2005 | AUSTIN
From The Economist print edition

Judges, both state and federal, feel they are hard done by

PITY the judges. Despite the supposed separation of powers, their pay is often set by state legislatures which tend to put teachers and firemen, not to mention themselves, first. Texas's do-nothing legislature failed to pass a judicial pay rise last month, so judges there have had the same money for six years. New York's judges have not had a pay rise since 1999, though Governor George Pataki recently introduced a bill to fix that.

Nowadays many first-year lawyers make more money than the judges they argue before. Illinois's trial-court judges, among the best-paid in the country, get $150,000, barely more than the $125,000 that new-minted graduates from the University of Chicago's law school earn at big-city firms. Nor can judges, unlike professors, pad their pay with outside jobs, lest it compromise their independence.

Judging used to be viewed as the culmination of a legal career, but one result of the pay discrepancy, says Tom Phillips, Texas's former chief justice, is that judges are getting younger. Last year the average age on the Texas Supreme Court was 51. Politics is also a factor; in many states, including Texas, judges are elected, so younger people may be better braced for the rough and tumble of campaigning. But they move on quickly when they have to put their children through college.

Matters may be worse at the federal level. True, federal judges earn more than state ones: Priscilla Owen, who was sworn in last week (after the filibuster deal) to the Fifth Circuit Court of Appeals, will see her salary jump to $171,800, riches compared with the $113,000 she got as a justice on Texas's highest court. On the other hand, federal posts carry more prestige, and, in contrast to the state system, the appointments are for life.

Congress, which holds the purse-strings, has not helped much. Federal judges' salaries have lost 24% of their purchasing power since 1969. In a report published in 2003, Paul Volcker, a former Fed chairman, called judicial salaries “the most egregious example of the failure of federal compensation policies”, noting that “too many of America's best lawyers have declined judicial appointments.”

The executive branch, which is better at lobbying for its interests and also has more independently wealthy people at the top, gets incentive pay far more often, according to a memo last month from the Administrative Office, the judiciary's representative in Washington. The legislature also gets treated better: staffers on House of Representatives committees can pull in $160,600, whereas workers in the judicial chambers are capped at $149,200. Federal judges are banned from receiving honorariums, and are allowed a maximum of $24,315 a year from work such as teaching or writing books. They can draw a full salary and good benefits if they retire at 65, but only if they have served for 15 years.

Between the 2001 and 2005 fiscal years, the federal workload was up 18%, but staffing had been cut. No relief is in sight. Congress's move to shift class-action cases from state courts to federal ones will probably mean hundreds more cases. And immigration filings in appellate courts rose by 600% between 2001 and 2004.

Judicial officials have asked Congress for $5.95 billion for their branch in fiscal 2006, a 9.7% rise. On current trends, they won't get that. Instead they are likely to face hard questions from Republican lawmakers, who loathe activist judges.

Congress has also turned a deaf ear to the judiciary's pleas about its payment of rent to the federal government for the use of courthouse properties. This eats up an astonishing 22% of the judicial budget and leaves no money to build new courthouses. Judicial advocates point out that the Department of

Defence does not pay rent for its Pentagon site and military bases, nor does the Treasury for its 15th Street headquarters in Washington, DC. In this case, Congress will be the judge.

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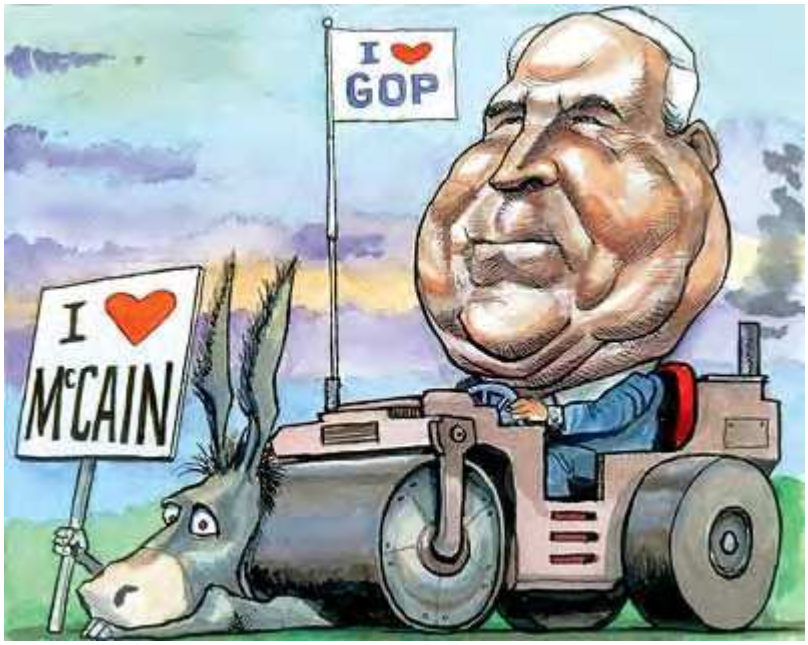
Lexington

Who is John McCain?

Jun 16th 2005
From The Economist print edition



The senior senator for Arizona is not what Democrats hope he is

HE IS every American liberal's favourite Republican. He has a long history of championing liberal causes such as campaign-finance reform (with Russ Feingold) and immigration reform (with Teddy Kennedy). He recently derailed the attempt by Senate Republican leaders to junk the delaying filibuster technique for judicial appointments; and he is one of Congress's leading worry-warts on global warming. A recent *Washington Post*-ABC News poll gave him higher favourability ratings among Democrats and independents (both 59%) than among members of his own party (56%).

The fawning adulation of many liberals for John McCain is mirrored by the foaming hatred of many conservatives. “We don't like McCain at all,” says Stephen Moore, a veteran anti-tax conservative. “He ought to not be allowed near sharp objects or legislation,” adds Grover Norquist, another anti-tax crusader. The Conservative News Forum refers to him as “Komrade McCain”. And that is all mild stuff compared with what the religious right says about him.

But the Komrade has a dark little secret: he is actually very conservative. That he is a maverick who likes nothing better than kicking against the pricks there can be no doubt. But he is a conservative maverick.

Mr McCain's Republican loyalties were directly tested in the 2004 presidential campaign, when John Kerry asked him to be his running-mate. The wooing was hot and heavy. But Mr McCain not only rebuffed his fellow Vietnam veteran. He threw himself into campaigning for his former nemesis, appearing in more than 20 events for George Bush. “Both candidates in this race are honoured to be the friend of John McCain”, Bush told a crowd in Reno, Nevada. “Only one of us gets his vote, and I am proud that it is me.”

There were two deciding factors during this period of competitive wooing. One was surely personal ambition: the 68-year-old senator turned down Mr Kerry because he wants the top job in 2008, not two terms as a number two. But there was also conservative principle involved—especially on foreign policy. Mr McCain was a supporter of the Bush doctrine *avant la lettre*. When Mr Bush was talking about the importance of having a “humble” foreign policy back in 2000, Mr McCain was preaching the virtues of

“rogue state roll-back”. He has long been a believer in the Reagan doctrine of linking American power with the spread of American values, not least in Iraq. And his foreign policy has not softened with time. He remains an articulate defender of the Iraq war—though also an equally articulate attacker of Donald Rumsfeld's handling of it. He is an outspoken critic of the authoritarian regimes in Saudi Arabia and Egypt, as well as of Vladimir Putin's “creeping coup” in Russia. If Mr McCain isn't a Reagan Republican when it comes to foreign policy, then nobody is.

To be sure, the senator's views on domestic policy are harder to pigeonhole. His support for campaign-finance reform infuriates libertarian conservatives, who worry that it limits free speech. His support for immigration reform appals conservative activists, who think that it condones law-breaking while opening the floodgates to more immigrants. His support for preserving the filibuster infuriated party loyalists, who want to get more conservatives on to the bench.

But in each of these cases there is a good conservative argument for his position. The campaign-finance system arguably encourages pork-barrel spending. How can politicians champion the conservative goal of a limited but effective government when they are in hock to special interests? Some of the biggest supporters of Mr McCain's immigration reforms are business people who want to bring the laws in line with the global economy, and homeland-security officials who want to be able to focus their resources on real threats to national security. Getting rid of the filibuster would not only have broken with 200 years of Senate tradition, but might also have allowed a future Democratic majority to push through radical reforms.

A soldier's strategy

The paradox of Mr McCain's politics is that he frequently clashes with conservative activists not because he wants to advance liberal goals, but because he wants to promote conservative ones. Mr McCain is a deeply conservative man by temperament. Both his father and grandfather were distinguished four-star admirals. He was educated at the Naval Academy rather than some namby-pamby liberal university, and spent five-and-a-half years as a prisoner-of-war in the notorious Hanoi Hilton. The heir to Barry Goldwater's Senate seat in Arizona, he's pro-free trade, pro-small government and, unlike his predecessor, pro-life. But he has never shied away from tackling conservative interest groups if he thinks that their focus on single issues (such as tax cuts or opposition to stem-cell research) gets in the way of good government.

This paradox will inevitably create problems for Mr McCain if he runs for the Republican nomination in 2008. The conservative activists with whom he has often feuded have a disproportionate influence in the Republican primaries. But, for all that, the activists have a lousy history of getting their champions nominated. (Back in 2000, Mr Bush presented himself as a pragmatic governor with a track record of working with Democrats.) And Mr McCain has some valuable chits to cash with the primary voters. For one thing, he has made his peace with the Bush machine that is at the heart of the modern Republican Party (E.J. Dionne, a *Washington Post* columnist, has even floated the intriguing idea of Mr McCain making Jeb Bush his running-mate). For another, he may be his party's best chance of avoiding, in the shape of Hillary, a Clinton restoration.

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Argentina

Full steam ahead into the dark

Jun 16th 2005 | BUENOS AIRES
From The Economist print edition

President Néstor Kirchner's government is going the wrong way about solving Argentina's looming energy crisis

Get article background

WITH sky-high approval ratings and a comfortable budget surplus, Argentina's president, Néstor Kirchner, can usually expect to get what he wants. But perhaps the greatest political risk he faces this year is the one thing he will never be able to control: the weather. As temperatures in Buenos Aires plunged to an unseasonable 5°C one weekend last month, residents turned up the heat, denying the owners of nearly 300 service stations their customary supply of compressed natural gas to sell. Around 30 of them threatened lawsuits after they were left with no gas at all. The cold front soon passed, but Argentina remains in the potential grip of a full-blown energy crisis.

After foreign firms invested some $50 billion in the country's newly privatised energy sector during the 1990s, Argentines grew used to fairly reliable power and heating. But during the 2001-02 economic crisis, the government converted dollar-denominated prices into devalued pesos and has kept most rates frozen ever since. Many firms left the country as their revenues collapsed, leading them to default on the hefty debts they had incurred, while those that stayed staked no further capital. As a result, investments dried up and state-imposed price ceilings led middle-class residents and industrial clients to over-consume the artificially cheap energy.

While this helped fuel Argentina's impressive economic recovery, it also overstretched its energy supply. Between 2000 and 2003, the country's natural-gas reserves dropped 21%. Last year, the government forbade many Argentine companies from fulfilling contractual obligations to sell gas to Chilean firms, and doled out $700m—5% of its discretionary spending total—on energy imports.

This winter, which officially begins next week, supply will again be tight. Experts reckon Argentina will need 20m more cubic metres of gas per day than it can produce at current state-imposed prices. A third of this is currently imported from Bolivia—a highly unreliable source given its current political unrest (see article). To curb demand, the government has called on most users to cut consumption by 10% or pay higher rates. It has also provided tax incentives to spur the exploration of new oil reserves. But this has not reassured the country's businessmen. According to one poll, 82% of big industrial firms have already taken measures to deal with the expected energy shortages.

So far, the government has failed to convince investors that it is committed to restoring a functioning energy market. After permitting price hikes for commercial and industrial users earlier this year, it has secured deals with a few more foreign utility firms. But it is refusing to permit extra charges on residential consumers ahead of October's congressional elections. Moreover, it is still threatening to disregard supposedly binding rulings against it by the International Centre for the Settlement of Investment Disputes, a World Bank tribunal, following indemnity claims brought by foreign utility companies. All this is hardly reassuring for the investors Mr Kirchner will need to court.

Argentines still bear, of course, the full cost of the energy they consume. But instead of paying for it through their utility bills, they do so through their taxes in the form of payments to foreign energy producers—especially to Mr Kirchner's friend and ally, Hugo Chávez, Venezuela's president, whose state-owned PDVSA company sold Argentina $260m of fuel oil last year. Meanwhile, the government is doing little to help the foreign firms with investments in Argentina to recover their capital costs. Ever more are deciding to leave. Last month, Electricité de France announced plans to sell its 90% stake in the Buenos Aires electricity distributor, Edenor.

Although the government insists that it has more than enough resources to avoid crippling energy shortages this year and next, devoting them to short-term solutions will only exacerbate the lack of capacity. Unless investments rise sharply and demand is contained, 2007—when Mr Kirchner is due for re-election—could prove a crunch point with possible blackouts, says Luis Sbértoli, president of SIGLA, an energy consultancy. “If customers don't pay through tariffs, taxpayers don't pay through the government, and companies don't pay through losses, the alternative is simply a worse service,” he argues.

With inflation well down from its worrying levels early in the year and with fiscal accounts extremely strong, Argentina is at little risk of another economic crisis. But according to Daniel Montamat, a former energy minister, the economy, which grew by around 9% in both 2003 and 2004, will need $2.2 billion per year in energy investment to keep it growing at just 3%, and $3.5 billion if it is to sustain 5% growth. High commodity prices, a yawning output gap, and an expansionary monetary policy have so far kept Mr Kirchner's party going. How he treats private investors in the months to come will determine if and when the lights go out.

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Bolivia

Cooling off

Jun 16th 2005 | LA PAZ
From The Economist print edition

A new president and expected early elections help calm the violence

Get article background

AFP

THURSDAY June 9th was a day few Bolivians will forget. After weeks of road blockades and boisterous protests the president, Carlos Mesa, had resigned, opening the way for the president of the Senate, Hormando Vaca Díez, a hate figure for the agitators, to succeed him. Mr Vaca Díez shifted Congress from La Paz, Bolivia's capital, to Sucre, seat of the Supreme Court, but the protesters followed. A miner was killed—the first casualty in 19 months of unrest—and it looked as if Mr Vaca Díez's accession to the presidency might spark the civil war that Mr Mesa had said would come. In La Paz, converted into a vast pedestrian mall by fuel shortages and the threat of violence, the few remaining pedestrians were hunched in fear.

After dark, Mr Vaca Díez relinquished his claim to the presidency, as did the next in line, the president of Congress's lower house. And so the office fell to Eduardo Rodríguez, the Harvard-educated head of the Supreme Court, who is expected to hold a general election later this year. It should produce something Bolivia badly needs: a government and Congress with the legitimacy to resolve disputes over natural resources, the rights of the poor and regional autonomy. But democracy may not produce the outcome the agitators want. Will they hold Bolivia hostage again?

“I cannot make political decisions,” declared Mr Rodríguez, who is counting on a “renewed” democratic system to address the protesters' grievances. He is enjoying a honeymoon. Peasants' and miners' movements have now dispersed from the centre of La Paz, but have promised to return if their main demands are not met. These include the renationalisation of Bolivia's oil and gas sector, now managed by multinationals, and the convening of a constituent assembly to rewrite the constitution in favour of the poor indigenous majority.

No such conditions were set by Fejuve, a group based in the slums of El Alto overlooking La Paz, for ending its blockade of the capital. It settled for negotiations on its main demands. Samuel Doria Medina, a cement tycoon and an early front-runner in the presidential race, believes elections will solve most of the problems. Past presidents have been elected with little more than a fifth of the vote. But he expects the next election to narrow down to “two or three” candidates, with the winner taking 40% or more. That would give the new president the support he needs to “end this bloody stand-off”. But there is still a risk that Congress will balk at new elections; this could provoke more unrest.

Peace will come only if the left wins an election, which looks unlikely, or compromises, which may happen. In a poll this week, Evo Morales, leader of a coca-growers' union and of the leading opposition party, attracted the support of just 6% of voters. He has tried before to broaden his appeal by moderating his views, only to be pushed back towards extremism by more radical leaders. The greater hope is that last week's toppling of a president and a pretender represents the peak of the social movements' influence. Fejuve's apparent surrender may be one sign of this. “The most radical leaders are weakening fast,” says Roger Cortéz, a political analyst.

But they have not given up. Social movements pressed their case with Congress on June 14th with a peaceful march. There are fights ahead over how to deal with the constituent assembly and regional autonomy which conservative eastern provinces want. Nationalisation might wait for the next president

and Congress. Radicals will seethe. But their power to do much more may—just may—be ebbing.

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Mexico

Quis custodiet ipsos custodes?

Jun 16th 2005 | NUEVO LAREDO
From The Economist print edition

Drug violence on the Mexican border

THE Roman satirist Juvenal famously asked the question “who guards the guardians?” In Nuevo Laredo, a city on Mexico's border with Texas, the answer seems to be, the *federales* do. On June 13th, agents from Mexico's national investigative police, accompanied by soldiers, detained the city's entire police force of more than 700 officers.

Their detention followed the murder on June 8th of Nuevo Laredo's new police chief. Within hours of taking office, he was shot dozens of times by unidentified gunmen. Three days later, a plainclothes federal officer, sent to investigate, was shot by a local policeman. In reaction, the government announced the creation of a new programme, dubbed “Safe Mexico”, aimed at curbing drug-related violence and corruption along the border and, indeed, throughout Mexico.

The city's police force is now being interrogated and tested for drugs. Those who test positive or are found to have ties to organised crime will be arrested; the rest will be allowed to return to work. Forty-one officers believed to have been involved in the shooting of the federal police officer have been taken to Mexico City for further questioning. But Nuevo Laredo's mayor expects most of them to return home within a few days.

Over 60 people have been murdered since January in this city of roughly 500,000 people. That is dire, but not as high as it sounds; it translates into a lower murder rate than Washington, DC, had in 2004, for example, and roughly a third of that city's rate during a crime wave in the early 1990s.

Officials on both sides of the border nevertheless feel overwhelmed. Betty Flores, the mayor of Laredo, Texas, is calling for state and federal help to stem what she calls the “spillover” violence from across the border. However, its main impact on the citizens of Nuevo Laredo has been indirect. They walk around the city with scarcely a passing glance at the soldiers, only distinguishable from local police by the writing on their uniforms. But many small-business owners report a 70-80% drop in trade since the violence picked up in January. In recent weeks, several bars and nightclubs have shut their doors for lack of business.

The size of Nuevo Laredo's tourist industry is dwarfed by the amount of trade that passes through the city. It is now America's largest inland port of entry, handling 40% of trade between the two countries last year. Regardless of whether or not Mr Fox's programme succeeds in curbing the violence, Nuevo Laredo's position as a trade hub seems secure; it is on the shortest trucking-route between Monterrey, Mexico's third largest city, and the United States.

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Haiti

On the brink

Jun 16th 2005 | PORT-AU-PRINCE
From The Economist print edition

It keeps getting worse

Get article background

A YEAR after a United Nations “stabilisation” force was sent to Haiti, the country is looking more unstable than ever. In a new report, the Brussels-based International Crisis Group (ICG) describes the situation as “explosive”. This week, Bernard Gousse, minister of justice and public security in Haiti's interim government, resigned amidst growing criticism of the government's handling of the crisis.

For months, large parts of the capital, Port-au-Prince, have been under the control of armed gangs. They have grown increasingly brazen, carrying out a spate of kidnappings, carjackings, home invasions and rapes. Most of the victims are middle or upper class. Those with relatives abroad are sending their children out of the country for the summer. Businesses are being forced to close.

The gangs appear bent on terrorising the private sector and strangling the economy in a bid to undermine critical elections, due this autumn. These are supposed to complete the transition back to democracy following the overthrow of President Jean-Bertrand Aristide in February last year. The ICG says a radical overhaul of the police and judiciary is needed to improve security before the voting “if the situation is to be saved”. It has called for the UN's 7,400-strong peacekeeping force to be boosted by the addition of at least 3,000 extra police. This is probably more than the UN can manage, though a 10% increase is now being considered.

Late last month, the American embassy ordered non-emergency staff to leave Haiti along with their families. Some saw this as a vote of no confidence in both the UN and Haiti's interim government. American officials deny this. “Haiti is a salvageable situation, but it requires urgent measures in the next weeks,” one official said. “It's vital there be elections as scheduled.”

The source of the violence is a lethal cocktail of abundant weapons, political polarisation and extreme urban poverty. Some of the gangs are believed to have political ties to the pro-Aristide Lavalas Family movement, while others are linked to anti-Aristide groups, the business elite, and drug traffickers eager to exploit the chaos. Police corruption has exacerbated the situation, creating a climate of impunity. UN forces have recently begun to adopt a policy of “zero tolerance” toward the armed gangs, but so far with little effect. “We did not anticipate the current urban war,” David Beer, the UN's Canadian police commander in Haiti, admits.

Mr Gousse gave no explanation for his resignation this week. But he had come under fire for the continuing detention of Yvon Neptune, former prime minister under President Aristide. Arrested a year ago, it was not until last month that he was finally charged with orchestrating the killing of opponents of his former boss. He has repeatedly gone on hunger strike claiming his total innocence. Mr Gousse also stands accused of ignoring alleged atrocities by police against pro-Aristide slum dwellers.

UN mission chiefs insist that security must go hand in hand with social and economic programmes for Haiti's poor masses. Despite pledges of more than $1.3 billion in aid at a donors' conference last summer, very little of it has reached Haiti. A new meeting is to be held in Montreal on June 17th at which the Canadians are hoping to crack some heads together. But time is running out. Many western diplomats believe that Haiti is now on the verge of becoming a “failed state”.

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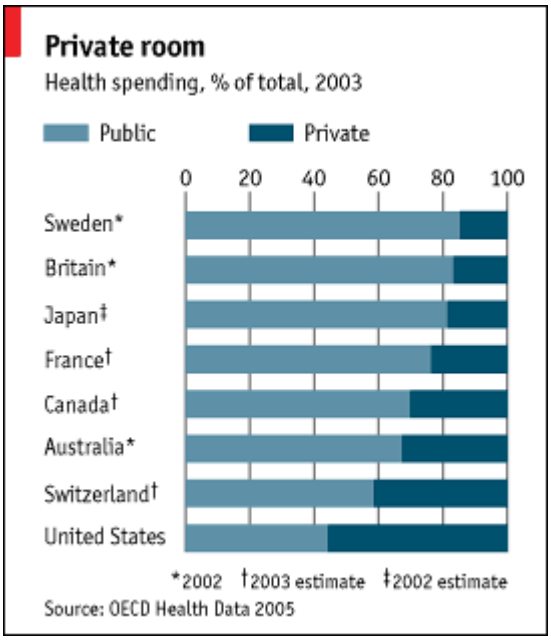
Canada's public health system

Private concerns

Jun 16th 2005
From The Economist print edition

The Supreme Court puts pressure on Canada's publicly funded medicine



CANADIANS are not a famously passionate people, but watch out if you touch their health care. For all its troubles of underfunding and long waiting times, most Canadians continue to take enormous pride in their state-funded medical system, not just as a public service, but as a reflection of national values that helps distinguish them from their mighty neighbour to the south.

Under the federal and provincial rules that govern Canada's health service, so-called “medically necessary” care is paid for out of public funds. Several provinces, among them Quebec, have an outright ban on private health insurance to cover such services.

Until last week, that is. Overturning two lower-court decisions, Canada's Supreme Court ruled on June 9th that a patient awaiting a hip replacement in Quebec was entitled to private health insurance to pay for a speedier private operation. The patient, a 73-year-old Montreal salesman, argued that the wait under the public system was unreasonable, endangered his life and infringed his constitutional rights. The court agreed.

Its 4-3 ruling means that Quebec's residents should be able to pay privately for medical services even if these are covered by the public health-care system. But Quebec's government is asking for at least a six-month stay of execution. Further court challenges can now be expected in other provinces with similar bans. Defenders of Canada's public health system are aghast, fearing a slippery slope towards two-tier American-style medicine.

But reports of the death of Canadian “socialised” medicine are exaggerated. It already co-exists with private health care. Almost a third of Canada's C$130 billion ($100 billion) medical bill last year was paid for out of private pockets. Private clinics have been springing up, notably in Alberta and British Columbia, offering services still scarce in the public system, such as MRI scans, or catering to patients covered by employer-funded workmen's compensation plans. But private medical insurance is limited, even in the four provinces that lack a Quebec-style ban.

It is too soon to tell what the ruling's impact might be. As Michael Rachlis, a Toronto health-policy analyst, points out, there are plenty of other barriers to medical privatisation. Ontario, for example, bans doctors from charging private patients more than the publicly funded fee for the same service. This limits the appeal of private medicine for practitioners, since most patients will wish to remain under the public umbrella. “If people think this is going to open an easy way to private insurance, they are dreaming in technicolour,” Dr Rachlis says.

Roy Romanow, former head of the national Commission on the Future of Health Care, which three years ago drew up a blueprint for reform, believes that the Supreme Court decision could even help the public system by kicking federal and provincial governments into action. Last year, government officials agreed on a ten-year $41 billion health-reform package. But progress has been slow. It is hoped that the Supreme Court's ruling will now stimulate a more urgent response.

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Bangladesh

State of denial

Jun 16th 2005 | DHAKA
From The Economist print edition

Extremism is a worry in Bangladesh; but it's the mainstream that is polluted

Get article background

THE most densely populated of the world's big countries, Bangladesh is also among the most sparsely covered by the international press. This is in part the government's choice: it makes it hard for foreign journalists to visit. When they do, it tends not to like what they write, especially recent suggestions that Bangladesh is witnessing a rise in Islamic extremism, and becoming a haven for international terrorists. The government is right that claims of “Talibanisation” are exaggerated. Bangladesh remains a relatively liberal and tolerant place. But it is becoming less so, and that is a concern.

Rich-country diplomats say that whereas, three years ago, their main focus was on economic development, it is now on defending democracy. Later this year, a number of such countries, who meet informally in Dhaka as “the Tuesday group”, are planning to hold a conference on the conduct of free and fair elections.

This is the burning issue in Bangladesh. Elections are due next year. Already, the main opposition, the Awami League, led by Sheikh Hasina Wajed, is threatening a boycott, alleging government attempts to rig the poll—this despite Bangladesh's unique system of conducting ballots under the eye of a supposedly neutral caretaker government. A boycott would formalise the deadlock between the League and the Bangladesh National Party (BNP) of Khaleda Zia, the prime minister. It is the bitterness and lack of trust between these two women and their parties that has hijacked the democratic process, and encouraged the growth of extremism.

The government says that if the League were to boycott the election, it would do so merely in fear of defeat. A recent poll has suggested the BNP might indeed win—in part because of the popularity of a brutal campaign against alleged criminals. Odhikar, a human-rights group, claims that 168 such people have been killed by security forces, “in crossfire”, in the first five months of 2005.

The Awami League is justifiably suspicious of the government. In August last year, 23 people were killed at one of its rallies in Dhaka in a grenade attack. Sheikh Hasina herself was lucky to survive. In January

this year, another party leader, Shah A.M.S. Kibria, a former finance minister, was also killed in a grenade attack. A number of people, including members of the BNP, were arrested for Mr Kibria's murder. But no one has been charged for the earlier crime.

These spectacular attacks are only the most visible symptoms of the disease: endemic political violence, in which both big parties are implicated. Local heavies act as their enforcers, in return for protection from politicians with sway in the police and judiciary. Odhikar reports that 526 people died in political violence last year.

The League says the BNP is hostage to two of its three junior coalition partners, Jamaat-e-Islami and the smaller Islamic Oika Jote (IOJ), both Islamic parties. It says that the BNP turns a blind eye to violence by Islamic extremists, and to all sorts of encroachments on Bangladesh's traditional tolerance.

Take the fate of Bangladesh's Ahmediya minority, who number some 100,000 out of a population of about 140m. Regarded as apostates by some Muslims, many have in the past 18 months been victims of a campaign of discrimination, expropriation and violence, documented in a report published this week by Human Rights Watch, a lobbying group. In January last year, at the insistence of the IOJ, the government banned Ahmediya publications. The law minister, Moudud Ahmed, concedes this was “a big mistake”, and says that the ban will be overturned in the courts.

There are also concerns that women are under pressure to wear the veil, that some traditional entertainment is being suppressed, and at the spread of Islamic schools teaching purely religious doctrine. But there are many forces in Bangladesh beside Islamism. The economy has been growing at a steady 4-6% a year for a decade. Bangladesh does much better than India, for example, in educating girls, and the success of microcredit lending is giving women improved status and income.

The BNP's Mr Ahmed insists the party leads a “centrist, slightly right” government. Jamaat's leader, Motiur Rahman Nizami, the industry minister, describes his party's main objective as “a welfare state based on the moral and social values of our religion”, but says it will pursue this through democratic politics. Jamaat's student wing, however, known as Shibir, has a history of violence, and Jamaat's opponents claim it has links with terrorist groups. Of these the most notorious is the Jagroto Muslim Janata, led by a thug known as Bangla Bhai, once a Shibir activist. Despite claiming Islamic credentials, and reports (which he has denied) that he once fought for the Taliban in Afghanistan, Bangla Bhai seems more like a gangster, engaged in a local power struggle.

Foreign diplomats say outfits like Bangla Bhai's do have links to international Islamic groups, but that they are not extensive. Of greater concern is the attitude of the BNP government: at first utter denial that the Islamists even existed; then, since February, when it banned the group, a half-hearted effort to eradicate it. India faces similar denials when it takes Bangladesh to task for allegedly harbouring some of the many separatist groups fighting in India's north-east. Even Manmohan Singh, India's mild-mannered prime minister, is exasperated: “We can choose our friends,” he commented recently, “but we cannot choose our neighbours.”

Bangladesh will be an even less attractive neighbour if the election leads to the breakdown of the political system, and, such is the animosity between the two big parties, this is possible. As it is, the judiciary and parliament are weak and dysfunctional. Neither party has a real interest in building strong checks on executive power. So elections become winner-takes-all contests. The biggest loser could be the country.

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Myanmar

On yer bike

Jun 16th 2005 | YANGON
From The Economist print edition

Government bungling makes cars a rare luxury

AP

Myanmar's mega-rich motorists

Get article background

FOR outsiders used to the gridlocked cities of South-East Asia, Yangon's leafy and uncongested boulevards make a pleasant change. For locals, however, they are just another reminder of the incompetence of their military rulers. The 5m inhabitants of the city own just 152,533 cars, say official statistics, or three cars for every 100 people. By contrast, some 3m vehicles ply the roads of Bangkok, in neighbouring Thailand. Myanmar's relative poverty must account for much of the difference, of course. But that poverty stems, in large part, from ludicrous government policies such as those governing the import and sale of cars.

Cars are so scarce because no one can afford to buy them. They cost a fortune, and not just by local standards. A 1993 Toyota saloon that can be bought for $1,000 from a Japanese wholesaler would sell for as much as $75,000 in Myanmar, according to one local's estimate. A brand-new Toyota Land Cruiser, at $300,000, costs six times what it would in America.

Prices are so high because the government has given a near-monopoly on imports to the Union of Myanmar Economic Holdings Limited, which is owned by the army. It sells the import rights to dealers for roughly $100,000 per car. On top of this, importers must pay a duty of 30% or more on the value of the car. Dealers, naturally enough, only bother to import top-end models that could justify such an outlay. But there is only a tiny market for such vehicles. So Myanmar, a country of 50m people, officially imported only 4,500 cars last year—and even that minuscule figure was a big increase on previous years. Another 1,500 vehicles were assembled inside the country, and sold at equally prohibitive prices.

The only economically viable way to bring cheaper, second-hand cars to Myanmar is to smuggle them across the border from Thailand. Various ethnic militias, allied to the junta and based in the border region, have imported perhaps 40,000 vehicles this way since 2000, with the connivance of the military-intelligence agency. But that once all-powerful body was abolished last year, after its leader, Khin Nyunt, fell from grace. Now the authorities are trying to round up all the smuggled cars. They have seized 14,000 so far, and are threatening anyone caught driving one with seven years in prison.

In all likelihood, therefore, the number of cars on the road this year will decrease. Prices, needless to say, have risen, by about 20% in the past few months. The government recently exacerbated the

shortage, by prohibiting car dealers from shipping old vehicles from the provinces to Yangon. It has also banned the import of second-hand spare parts.

The junta seems oblivious of, or indifferent to, the ill effects of all this. In 2003, it accidentally precipitated a bank crash, which is still crimping the economy. The top generals, schooled under past socialist regimes, are thought to have only the woolliest idea of how market forces work. No one dares set them straight. Pliant bureaucrats recently estimated last year's economic growth rate at 12.6%, which is higher than China's. For the automotive sector, at any rate, it looks as if they forgot a minus sign.

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The Philippines

A dangerous game

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From The Economist print edition

Gloria Arroyo faces down allegations of corruption

Get article background

GLORIA ARROYO, the president of the Philippines, claims to be focusing on economic reform “like a laser beam”. If so, she is alone: the rest of the country is transfixed by the various scandals besetting her and her family. Last week, a tape recording surfaced in which Mrs Arroyo appears to be encouraging an election commissioner to rig last year's presidential poll on her behalf. A few days before that, several witnesses at a Senate hearing had accused her husband, son and brother-in-law of receiving kickbacks from kingpins of *jueteng*, a popular but illegal form of gambling akin to a lottery. This latter charge is particularly incendiary, since Mrs Arroyo first became president when her predecessor, Joseph Estrada, was deposed by protesters who claimed that he, too, was pocketing *jueteng* lucre. The president's critics are now calling for another round of “people power” protests to topple her too.

Mrs Arroyo and her relatives deny all the allegations against them. It is the president's voice in the recording, a spokesman says, but her words have been doctored to create the impression of impropriety. The former intelligence agent who disseminated the tape says he got it from a surveillance expert in the army. But the expert in question denies this. He also claims the president's accusers held him hostage in a Catholic seminary in an attempt to bully him into corroborating their story. The police, whom answer to the president, are hunting for the whistle-blowing spy, who they accuse of sedition. The House of Representatives is due to start hearings next week to grapple with the matter.

Meanwhile, the Senate's hearings on *jueteng* are also generating plenty of theatrics. So far, several witnesses, who described themselves as bagmen for *jueteng* bosses, have told the senators that they helped deliver cash to various officials and politicians, including the president's relatives. One claimed to have personally handed bribes to Juan Miguel Arroyo, the president's son, and Ignacio Arroyo, her brother-in-law. Both Messrs Arroyo, who reject all these claims as politically motivated, are suing their accusers for libel.

The president, meanwhile, is trying to maintain as dignified a pose as possible. She has instructed both the justice department and the ombudsman to conduct independent inquiries into the *jueteng* allegations against her relatives, and to “let the chips fall where they may”. She has also ordered the police to crack down on *jueteng*. They duly claim to have eliminated the game from Luzon, the Philippines' most populous island, to general incredulity.

Mrs Arroyo has weathered such storms before. In 2001, she faced down angry mobs protesting Mr Estrada's ouster, and, by extension, her elevation from vice-president to president. In the run-up to last year's presidential elections, one of her rivals, Panfilo Lacson, accused Jose Miguel Arroyo, the “first gentleman”, of amassing an enormous political slush fund under a false name. But the charge, which Mr Arroyo denied, did not move the electorate: in the end, Mrs Arroyo easily beat both Mr Lacson and Fernando Poe, a matinee idol. Mr Poe's supporters also resorted to street demonstrations, but these fizzled out too.

The current protests seem equally limp. Only about 1,000 demonstrators showed up at a rally outside Congress on June 15th—a far cry from the hundreds of thousands who marched against Mr Estrada in 2001. The death of Poe last year deprived the president's opponents of their most popular leader. Nor is the opposition strong enough to pass the impeachment motion that some legislators would like.

On the other hand, Mrs Arroyo never quite managed to dispel doubts about her legitimacy during her first three years as president, while serving out the remainder of Mr Estrada's term. Her election victory last

year was supposed to quell such questions once and for all, and pave the way for a more confident and vigorous administration. Now, one year into her six-year term, doubts are resurfacing.

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The Philippines

Watch what you write

Jun 16th 2005 | MANILA
From The Economist print edition

One way to deal with irritating reporters

Get article background

THE Philippines prides itself on being a liberal democracy, with media freedom to match. Yet, Iraq apart, it is the world's most dangerous country for reporters. Last year, 13 Filipino journalists were murdered. Since democracy was re-established in 1986, 68 journalists have been killed, and in only one instance was anybody convicted.

The latest victim was Philip Agustin, the publisher of a weekly newspaper in the northern town of Dingalan. He was shot dead on May 10th as he sat down to dinner in his house. He had with him 500 copies of his newspaper, featuring reports on corruption in Dingalan.

President Gloria Arroyo recently inaugurated a bounty scheme—the Press Freedom Fund, which is worth 5m pesos ($93,000)—to encourage people to volunteer information to help solve these crimes. But whatever is said about the rule of law in Manila does not necessarily apply in the provinces. Agustin's murder was typical: he was a local man critical of local wrongdoing. Journalists based in the capital who criticise the federal government are rarely attacked.

Part of the problem is the general state of lawlessness. Local bigwigs riled by the words of a scribbler can easily find an assassin (for about 5,000 pesos, $93) to end the matter. Witnesses, policemen and prosecutors can be persuaded to turn a blind eye just as cheaply. Another factor, though hardly a justification for murder, is that many local hacks are shysters, given to raking up (or making up) dirt on local dignitaries, and then blackmailing them to keep it under wraps. A senior policeman suggested that the penalties for libel should be increased, to discourage such unscrupulous behaviour. Other officials have suggested that journalists should carry firearms in order to defend themselves. A few already do.

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Australian crime

Murder and market forces

Jun 16th 2005 | MELBOURNE
From The Economist print edition

Dirty deeds in Australia's most respectable city

Get article background

EVER since Melbourne lost its status as Australia's business and finance capital to Sydney some 20 years ago, it has been striving to compete with the larger city. As it prepares to host the Commonwealth Games in 2006, the biggest event in its history, Melbourne is preparing to re-market itself as Australia's most progressive metropolis. But recently it has also taken on a title that it would have much preferred to leave to Sydney: Australia's capital of crime.

In recent years, Melbourne has been racked by a series of murders between rival underworld gangs leaving, at the last count, about 30 corpses. The killings were accompanied by a degree of violence to put Sydney in the shade. Sydney, Australia's oldest city, founded by British convicts in the late 18th century, has always prized its more colourful criminals. But Melbourne, which began as a free settlement almost 50 years later, has traditionally considered itself more law-abiding. Not any more. The city's affluence has spawned turf wars between rival gangs, especially over control of the booming market in amphetamines and other drugs.

As Melbourne's police force initially held back, competing drug lords have rubbed each other out. The first to go was Alphonse Gangitano, shot dead in his home in 1998. The following year, Carl Williams, who is now awaiting trial on four separate murder charges, was wounded. Both shootings touched off a chain of retaliatory killings. The most gruesome involved the Morans, a family of big-time drug dealers. Mark Moran was killed outside his house in 2000, then, three years later, his brother Jason, who police believe was involved in the Gangitano and Williams shootings, was killed by a masked gunman in front of his twin children. Last year, Mark and Jason's father, Lewis Moran, was murdered. Last month, three men were charged with his killing. In all—and despite a code of silence among the victims' families and comrades-in-crime—Victoria state police have laid 51 charges, 20 of them for murder and conspiracy to murder. But the first trial ended on June 15th in disappointment for them: Dominic Gatto, known as “The Don”, was acquitted over the murder of a former bodyguard of Carl Williams last year.

The police themselves have not escaped contagion, following the murder of Terrence Hodson, another drug dealer, and his wife last year. An inquiry in February revealed that a police report, identifying Hodson as a police informer, had been leaked to the media. It was suggested that the leaker was a former police officer against whom Hodson had been due to give evidence over an alleged drug theft.

The government of Victoria has set up an independent body, the Office of Police Integrity, supervised by George Brouwer, the state ombudsman, to look into the matter. Mr Brouwer takes a laid-back view of the gang murders, as “an example of unbridled market forces at work.”

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Hong Kong

A knight of the people's paradise

Jun 16th 2005 | BEIJING
From The Economist print edition

Donald Tsang is blessed in Beijing

AP

One official, two systems

THERE was a time when China's supporters in Hong Kong dismissed Donald Tsang as a British stooge. But this week, with China's backing, he effectively secured the territory's highest post, raising the intriguing prospect of the proud recipient of a British knighthood in a job previously defined by the incumbents' unquestioning loyalty to the Communist government in Beijing.

In 1997, when Britain handed Hong Kong back to China, there was even speculation that Mr Tsang (who shrewdly chooses not to call himself Sir Donald) would be ejected from the top echelons of the government he had served for three decades under colonial rule. He had worked closely with Chris Patten, Hong Kong's last British governor and a strident critic of Chinese policy toward the territory. Although in the last two years of British rule he was responsible for financial affairs, he occasionally spoke out against attempts by China to interfere in Hong Kong's administration.

But China's strategy for dealing with Hong Kong, and apparently its attitude towards Mr Tsang, have changed markedly since hundreds of thousands of people took to the streets on July 1st 2003 to protest against a proposed new law against subversion and to call on Mr Tsang's predecessor, Tung Chee-hwa, to step down. Even though Mr Tung, a former businessman, was unswervingly loyal to Beijing, Chinese officials came to regard his lack of political nous and charisma as a threat to stability. In March they accepted his resignation, ostensibly for health reasons. And in an unusual concession to public opinion, they offered strong implicit support to the far more popular Mr Tsang, in his bid for the top job. According to recent polls, he is supported by 70% of Hong Kongers.

This has caused unease among some members of the pro-China camp. Although Mr Tsang—a devout Roman Catholic—was retained as a top official in the post-colonial administration and became Mr Tung's most senior deputy in 2001, he was still regarded with some misgiving by long-time supporters of the Communist leadership in Beijing. Instead of displaying immediate support for Mr Tsang's candidacy, as officials in Beijing would no doubt have liked them to, some pro-China figures in Hong Kong initially dithered.

With China's obvious endorsement, however, the dressy Mr Tsang (who was taught how to do up his trademark bow-ties by a British official) was a shoo-in. On June 15th he became, in effect, chief executive-elect. No other contenders secured the necessary 100 nominations from members of a nearly 800-strong election committee (which is packed with China's supporters) to qualify as candidates. Mr Tsang said he had received the support of 710 members. His appointment still awaits formal ratification by the government in Beijing, but there is not the slightest doubt that he will be sworn in, probably within the next few days.

Pro-democracy (the opposite of pro-China) groups in Hong Kong grumble about China's refusal to introduce elections by universal suffrage. They also criticise China's decision to allow Mr Tsang initially to serve out only the remaining two years of Mr Tung's term, instead of a full five years. This has been widely seen as a way for China to replace Mr Tsang swiftly if he fails to meet its expectations. But many believe that Mr Tsang will try harder than Mr Tung to win over the democrats, and that China wants him to succeed.

Lee Wing Tat, the chairman of Hong Kong's biggest pro-democracy party, the Democratic Party, and until he ceded defeat this week a would-be candidate for chief executive, says Mr Tsang will be more effective than Mr Tung at reconciling different views, at least on economic and social issues.

Choy So Yuk, a pro-China legislator, says members of her circle “have an impression that he is one of the democratic camp, or more of the democratic camp than of the [pro-China] camp.” But Mr Tsang is cautiously vague when describing his hopes for democratisation in Hong Kong. Many pro-democracy politicians say he will be careful not to upset the Chinese leadership.

Mr Tsang may prove more fortunate than Mr Tung, much of whose time in office was plagued by a severe economic downturn not of his own making. The economy is showing strong signs of recovery. China is not putting pressure on Mr Tsang to revive the anti-subversion legislation that backfired so dramatically against Mr Tung, and Mr Tsang says he is not planning to do so.

Public demand for more rapid progress toward full democracy for now appears muted. Mr Tsang says his policy will not be markedly different from his predecessor's, only that he will try to make it “more focused, more coherent”. For many in Hong Kong, this would appear to be a good enough start.

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Syria under Bashar Assad

One of the last survivors of a dying breed

Jun 16th 2005 | ALEPPO, DAMASCUS AND QAMISHLI
From The Economist print edition

Reuters

The regime shows no sign of collapse but under the surface all is not well

HOT winds scour the open plains of north-east Syria, whisking the chaff from a record wheat harvest into twirling genies and churning up dust clouds that seem to swallow whole villages of squat mud houses. Giant lorries ferry herd-loads of sheep to Iraq for sale, passing a returning stream of greasy tankers hauling smuggled petrol.

Away from the crush and intrigue of Damascus, Syria seems a peaceful and ruddily self-reliant if not prosperous place. Yet the appearance, like the cheap Iraqi fuel that tends to be diluted with engine-killing water, is deceptive. Here in the north-east, a sense of ferment extends not only to the large and much-oppressed Kurdish population. Poor native Arab tribes complain of perks, jobs and guns granted to tribeless Arab outsiders, settled here under the ruling Baath party's policy of diluting the mistrusted Kurds. Youthful Bagara and Tayy tribesmen, who have cousins in Iraq, are restive for a different reason. Fired by stories of *jihad*, and with the livelihood of smuggling threatened by shoot-first American patrolling of the border, they are said to chafe at being kept from fighting the infidel intruders.

Such tensions do boil over. Earlier this month, some 50,000 Kurds gathered in the dusty centre of Qamishli, the main (largely Kurdish) town of the north-east, to protest against the mysterious murder of a popular reformist preacher, Sheikh Mashuq Khaznawi. When a smaller group tried to join, say the Kurds, police beat them back before parting ranks to allow a rabble of slum-dwelling Arabs to pillage Kurdish-owned shops. Pamphlets had earlier been distributed that accused the Kurds of being “agents of Bush and Mossad”. Kurdish activists say most of the looters appeared to be from Baathist youth groups.

Syria's Kurds, 10% of the country's 18m people, are used to such things. Forty years ago, 100,000 of them were stripped of Syrian nationality. They and their descendants still have no right to passports, official employment or property ownership. In the 1970s, thousands more lost their lands when the state “Arabised” a 10km (six-mile) strip along the long Turkish border. Syria has no Kurdish ministers, generals, senior judges or Baath party officials. The country's dozen Kurdish parties that demand such things as language rights and fair parliamentary representation, are officially banned. Amnesty International lists Sheikh Khaznawi as the sixth Syrian Kurd to have died as a result of police ill-treatment in the past 15 months alone.

Obviously, Kurds share the general scepticism with which other Syrians greet the talk of reform coming now from Damascus. Such talk grew loud in advance of the Baath party congress earlier this month. In the event, the rhetoric sounded musty as ever, and the announced changes looked puny. These included, among other things, a review of the emergency laws that have been applied since the Baathists took power in 1963, moves to disentangle the party from the state, and laws to lift some restrictions on the press and on the formation of political parties.

Many foreign commentators described Syria's government as having missed a last chance to improve its image at the congress. Noting mounting troubles, from Syria's recent humiliating exit from Lebanon, to American sanctions, to anger over Syria's alleged failure to stop *jihadis* crossing the border into Iraq, to falling oil sales, soaring unemployment and stirring unrest among Kurds, Sunni Islamists and liberal intellectuals, some predicted an early end to Baathist rule. The latest rumblings from Washington, moreover, indicate that the Americans, after some hesitation, have opted to isolate the Baathist government still more. They will blame Syria for any political violence in Lebanon. And they have hinted at plans to impose a no-fly zone or perhaps a security corridor on Syria's side of the Iraqi border.

Yet, perhaps because they are used to being governed very badly, knowledgeable Syrians seem less edgy than might be expected. Five years after he succeeded his ruthless father, President Bashar Assad, aged 39, has certainly not lived up to initial hopes for change. The early release of hundreds of political prisoners was followed by the rounding up of dozens more. Moves to liberalise the economy became mired in corruption and red tape. Often, Mr Assad seemed to have little control over fiefs carved out by his father's cronies.

But there is no sign that the younger Assad's grip is weakening. In some respects it may be growing stronger. This is not only because opposition to Baathist rule has failed to coalesce: witness the Kurds' 12 rival parties. Nor is it only because middle-class Syrians, wary of the messiness of their similarly sectarian neighbours, Iraq and Lebanon, tend to prefer the devil they know to ones they don't. (“Of course we all want change,” says a Damascus trader. “But when you ask at what cost, most of us shut up.”) Mr Assad remains peculiarly popular. This is hard for anyone who did not live under his father's regime to imagine. But simple things like allowing satellite dishes, letting the internet spread and cutting import duties have won him a great deal of goodwill.

Mr Assad has also, slowly but with increasing urgency, drawn the levers of power into his own hands. The Baath congress was less notable for action it failed to take than for Mr Assad's sweeping changes in his ruling circle. Sixteen of 21 members of the Regional Command, the party's governing body, got sacked. The new command, cut to 15 members, is dominated by younger types directly loyal to the president. Similar changes have overtaken the army and security forces. Even in private business, Mr Assad's close kin and friends, many from his Alawite sect that makes up a bare tenth of Syria's population, have elbowed themselves into dominance.

And there are signs that the president, despite speechifying over the glories of the Baath, will ignore the party if necessary. The recent appointment of a respected non-Baathist, Abdullah Dardari, as deputy prime minister with broad oversight of economic policy, suggests a will to push the limits of the party's new-found commitment to what it calls a “social market economy”. About time. Forty years ago, Syria was the second richest of 22 Arab countries. Now its ranking has dived.

Yet if Mr Assad has given himself better means to effect rapid change, he must act quickly. The world is watching closely. He has been humiliated in Lebanon. His people are disillusioned, restless and tired of isolation. The Americans want him out. Despite his grip on the organs of repression, his long-term prospects for turning his country round—and staying on top of it—look increasingly bleak.

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Israel

Moses's oily blessing

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Two seekers for oil in Israel may be getting close to the prize

“MOSES dragged us for 40 years through the desert to bring us to the one place in the Middle East where there was no oil”, quipped Golda Meir, one of Israel's prime ministers. Now two men hope to prove that not only is there oil, but that Moses pointed to it.

In the 1980s John Brown, a Catholic Texan cutting-tools executive, and Tovia Luskin, a Russian Jewish geophysicist and career oilman, both had religious epiphanies. Mr Brown became a born-again Christian, while Mr Luskin joined the orthodox Jewish Lubavitch movement. Soon after, each found inspiration in chapter 33 of the book of Deuteronomy, in which Moses, nearing death after guiding the tribes of Israel to the border of the promised land, leaves each tribe with a blessing.

The most lavish goes to Ephraim and Manasseh, the two tribes descended from Joseph (he of the technicolour coat). Their land, says Moses, will yield the “precious fruits” of “the deep lying beneath”, of the “ancient mountains” and of the “everlasting hills”. In this text Mr Luskin saw, says his company's lawyer, “a classic description of an oil trap”. Where geological sediments are bent into an arch, the boundary at the top between an older layer (the “ancient mountain”) and a newer one can trap oil—the “precious fruits”. Mr Luskin named his company Givot Olam—“everlasting hills”. Mr Brown had a more mystical revelation, but one that pointed to the same area (see map): the biblical territories of Ephraim and Manasseh, between today's Tel Aviv and Haifa. He registered his firm as Zion Oil.

Both men spent the following years raising capital and grounding their visions in science. Seismic studies confirmed the arched rock layers that Mr Luskin was looking for. Mr Brown pinpointed an area with evidence of buried Triassic-era coral reefs, which are usually porous and store oil well.

Givot Olam has drilled three wells since 1994 and found oil, but not enough to be worthwhile. It is now back in one of them, trying a new technique of drilling. Mr Brown, meanwhile, is extending his well to a depth where he hopes to find the oil-rich reefs.

Israel has oil and gas wells, but very few; oil majors with big investments in Arab countries have found it prudent to stay clear. Both companies reckon that if their calculations turn out to be accurate, their

oilfields could yield tens or hundreds of millions of barrels, enough to make Israel (which consumes some 100m barrels per year) partly self-reliant. In the next few weeks, both should learn whether Moses's blessing is theirs to take.

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Iran

Bombs amid polls

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From The Economist print edition

The presidential election campaign hots up in more ways than one

Get article background

"PSYCHOLOGICAL warfare" is how Ali Yunessi, Iran's intelligence minister, described a spate of explosions that went off around the country on and after June 12th, killing seven people in the south-western town of Ahwaz and three in the capital, Tehran. He and other officials believe that the bombers' common aim was to throw Iran's presidential election campaign into disarray a few days before the polls opened, on June 17th, and to keep nervous voters at home.

Iranian officials have been at pains to distinguish between the three big bombs that targeted government officials in Ahwaz and the amateurish devices that exploded in Tehran and other places, including Qom, a seminary town. Many have linked the Ahwaz bombs to April's ethnic rioting there, which was probably caused by agents provocateurs and brought members of the city's Arab minority into conflict with the police. (The Arabs came out worse; five were killed.) Three Arab nationalist groups have put their names to the Ahwaz explosions, but the bombers, says Mr Yunessi, "have links abroad".

That would not be a surprise. Khuzestan, the oil-rich province of which Ahwaz is the capital, is home to most of Iran's 3m Arabs, and neighbouring Arab countries have a long tradition of stoking irredentism there. The Iranians feel uncomfortably close to the chaos across the border in Iraq, where they have as many enemies among the Sunni minority as they have friends among their fellow Shias. One official said that the bombs that went off in Ahwaz had similar devices to those used by Saddam Hussein's security forces. Another blamed the Americans and British for sending bombers across the border.

All agree that there was a foreign hand behind the Ahwaz blasts; there is no such consensus on whom to blame for the other explosions, which started several hours later. This week, an ally of Mostafa Moin, the reformist who aims to replace the outgoing president, Muhammad Khatami, observed drily that the conservative candidates, rattled by Mr Moin's recent surge in the polls, have most to gain from the increased insecurity. In private, another reformist official said that some conservative hardliners had been arrested in connection with the Qom explosion.

Whatever the truth, Mr Moin has had a good week, while his conservative foes have struggled. The editor of *Keyhan*, a hardline newspaper, castigated the conservatives for failing to unite around a single candidate, thus splitting the conservative vote; later this week, one dropped out.

Fighting against voter apathy and public scepticism over the reformists' ability to keep promises in the face of an all-powerful conservative establishment, Mr Moin's allies have campaigned vigorously—and to good effect. Some recent polls suggest that he has edged into second place, ahead of Muhammad Ghalibaf, a former police chief running as a modernising conservative, and that he is well-placed to challenge Akbar Hashemi Rafsanjani, a pragmatic former president and long-established front-runner, in a run-off between the two leading candidates, provided none gets more than 50% in the first round.

The Moin campaign's new zip was evident at a well-attended rally in Tehran on June 14th. The most effective speakers were reformists who said that they had favoured boycotting the election in protest at the conservatives' disdain for democracy, but that they now believed that voting was the only way to prevent repression. "I hear the sound of military jackboots," declared one such reformist, Fatemeh Haqiqatju, in a dig at the military background of some of the conservative candidates.

As polling day drew near, Mr Moin threatened to withdraw from the race in protest against attacks on his supporters by conservatives. Such violence appears to have increased along with his popularity. A former

parliamentary speaker now in the Moin camp was assaulted by conservative zealots as he tried to address a reformists' rally in Qom.

The campaign had threatened to be a pointless yawn when Mr Moin was disqualified from standing by a conservative watchdog body. Then the country's supreme leader, Ayatollah Ali Khamenei, stepped in to reinstate him. The result is the most pluralistic and unpredictable presidential contest since the 1979 revolution—and a surprisingly good advertisement for Iran's supervised semi-democracy.

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South Africa

The president hits out at corruption

Jun 16th 2005 | JOHANNESBURG
From The Economist print edition

Why it wasn't easy for Thabo Mbeki to fire his deputy

Get article background

EPA

Jacob goes down the ladder

LESS than a month before the leaders of the world's eight richest countries gather in Scotland with Africa at the top of their agenda, Thabo Mbeki, South Africa's president, has sent an unequivocal signal that he is serious about rooting out corruption. On June 14th, he told parliament that he had decided to sack his deputy and potential successor, Jacob Zuma, whose future had been under a cloud since his personal financial adviser, Schabir Shaik, was sentenced earlier this month to 15 years behind bars for corruption and fraud.

Mr Mbeki's decision is both courageous and timely, since the British government is trying to convince the rest of the G8 that in spite of African governments' torpor in tackling corrupt and repressive regimes such as Zimbabwe's, the continent still deserves more aid in exchange for better governance. Mr Mbeki's dismissal of his deputy was not easy. Though Mr Shaik was found to have had a “generally corrupt” relationship with Mr Zuma, the former vice-president has not been charged with any crime; the National Prosecution Authority is still mulling over whether it has a strong enough case to take him to court. But the president concluded that it was still best for “our young democratic system” that Mr Zuma should go.

A victim's furious friends

His sacking will anger his many supporters, who insist he is the victim of a conspiracy, with no reason to step down without a chance to clear his name in court. The Congress of South African Trade Unions (Cosatu) had previously said it was “outraged” by suggestions that Mr Zuma should resign or be fired, and implied that his sacking would badly damage its “tripartite alliance” with the ruling African National Congress (ANC) and the once-powerful Communist Party. The ANC Youth League said the trial had nothing to do with Mr Zuma, and launched a personal attack on the (white) judge.

The ANC's rank and file admire Mr Zuma as a man of the people. His humble background, consultative leadership style and jovial charisma contrast with Mr Mbeki's image as intellectual, remote and divorced from the concerns of ordinary people. A Zulu with little formal education, Mr Zuma rose to become the ANC's head of intelligence after serving ten years in prison for fighting against apartheid. He also won more recent plaudits for helping to reconcile the ANC with the Zulu-led Inkatha Freedom Party.

There have been rumblings of discontent lower down. Last month, frustration over poor public services and lack of new housing provoked violent protests in several cities. Last week, Ebrahim Rasool, who had been endorsed by Mr Mbeki as premier of the Western Cape province, lost an election for the ANC chairmanship. The same could happen in Mpumalanga, another of the country's nine provinces, where the ANC is about to elect its leaders.

The ANC's spokesman says the party “is not—and cannot be—divided over the outcome of the Schabir Shaik trial”. Mr Zuma says he respects the president's decision and has given up his seat in parliament, though he remains the ANC's number two. The ANC's collective leadership endorsed Mr Mbeki's decision. For the moment, the ANC is holding together.

Nor, at this point, are the ANC's allies likely to break away in protest. Zwelinzima Vavi, Cosatu's leader, says he is “devastated” by Mr Zuma's sacking, but the trade unions have no other party to ride with. And though there have been discussions in the Communist Party over whether to field its own candidates in future elections, it knows it would get few seats if it did so. Moreover, argues William Gumede, author of a book on Mr Mbeki and the ANC, these ineffectual reactions to Mr Zuma's fall show that the ANC's trade union and communist allies have lost influence. Ahead of its national general council at the end of this month, the ANC has already published discussion papers suggesting, among other things, that the labour market should be more flexible: anathema both to the unions and the communists.

Those mentioned as the next vice-president—and Mr Mbeki's potential successor—include the defence minister, Mosiuoa Lekota, and the foreign minister, Nkosazana Dlamini-Zuma, who happens to be Mr Zuma's former wife.

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Ukraine's government

The Viktor and Yulia show

Jun 16th 2005 | DONETSK, KIEV AND LVOV
From The Economist print edition

Reuters

Six months after the heady "orange revolution", what has Ukraine's new government actually achieved?

Get article background

SOME things have changed forever. Many Ukrainians say that, since the huge street protests last November and December that culminated in Viktor Yushchenko's victory in the presidential election on December 26th, they are much freer. The new government's critics, unlike the old one's, happily give their names to journalists. There have been more tangible advances: some businesses have been corralled out of the shadow economy, boosting tax and customs receipts, and helping to pay for higher pensions and public-sector wages. But there have also been disappointments—and not all were inevitable.

Amid all his rhetoric about driving the bandits out of government, Mr Yushchenko made a few specific pledges. One was to review the dodgiest of the privatisations done by his predecessor. The Ukrainian (and a few Russian) owners of the likely targets have, predictably, resisted. But prevarication by Mr Yushchenko and his prime minister, Yulia Timoshenko, is more surprising. The number of firms, the criteria for choosing them and the mechanics of re-privatisation are all unclear. The government hoped to give investors more clarity at a World Economic Forum meeting in Kiev this week, but the impression of incompetence will linger.

Another imperative should have been to allay anxieties about a Yushchenko presidency in southern and eastern Ukraine, which overwhelmingly backed his rival, Viktor Yanukovich. Mr Yanukovich's supporters still cannot muster the verve of Kiev's orange-clad masses in the winter snows. But in Donetsk, at least, resentment of Mr Yushchenko persists.

The east's suspicions were sharpened by the arrest in April of Boris Kolesnikov over the allegedly violent takeover of a Donetsk department store. Mr Kolesnikov is an ally of Mr Yanukovich, and of Rinat Akhmetov, Ukraine's richest man, who jointly controls a big steel mill that is a candidate for re-privatisation. Nobody thinks Mr Kolesnikov is a saint; but his detention is seen as a show of power against the eastern oligarchs. In Russian-speaking Donetsk, Mr Yushchenko's talk of cleaning up government sounds disingenuous. When asked if the new regime is as corrupt as the old, one Donetsk

businessman says: “not yet, but it will be soon.”

There have been sins of commission too, especially on economic policy. “They've been screwing up,” comments one western diplomat in Kiev. The most egregious example came when Ms Timoshenko—a formidable revolutionary, but a rash prime minister—imposed price caps on fuel, alleging an anti-Ukrainian conspiracy by Russian energy firms. Predictably, this measure led to fuel shortages. Mr Yushchenko's intervention to remove the caps provoked a contretemps; the president was rumoured to have suggested that the prime minister might consider resigning. Other missteps include a failure to pass the measures needed to get Ukraine into the World Trade Organisation.

To some, Mr Yushchenko's bigger goal—to get Ukraine into the European Union—looks imperilled by the recent French and Dutch referendums. But that gloomy view rests on an overly optimistic premise. However enthusiastic the West is about Mr Yushchenko, EU membership was always a long way off. Relations with Russia, meanwhile, have been civil but fragile. The need to preserve civility may explain why the poisoning that debilitated Mr Yushchenko during the election campaign, and scars him still, has not yet been publicly solved: some sort of Russian connection is widely assumed in Kiev. The solution of another infamous mystery—the murder of Georgi Gongadze, a journalist, in 2000—has been hampered by the inconvenient deaths of key witnesses.

Revolutions may change governments, but they cannot instantly transform a country. And Mr Yushchenko should not be blamed for some of Ukraine's most intractable problems. The biggest, as in most post-Soviet countries, is corruption. Some businessmen say things are improving, albeit confusingly. “Six months ago I knew who, when, how much,” says one Russian visitor to Donetsk. “Now I don't.” Petro Oliynyk, the new governor of the Lvov region, says that 200 of the local tax administration's 3,000 employees have been replaced. But the clean-up has had unintended consequences: post-revolution bribes are said to have gone up, thanks to a risk premium added by unreconstructed mid-level officials. “We could make a book of taxation jokes,” says Yaroslav Rushchyshyn, a pro-Yushchenko Lvov businessman. The beautiful city of Lvov is still crumbling; as Ukraine's growth slows, many young people from the countryside around it prefer to work illegally over the border than earn a pittance at home.

If some of the disappointments of Mr Yushchenko's short tenure can be put down to inflated expectations after last year's drama, others stem from the exigencies of the revolution. Various bits of the alliance that propelled Mr Yushchenko to the presidency had to be paid back with government offices. The result has been contradictions and cleavages, both ideological—eg, between the economic liberals and the socialist who oversees the state property fund—and personal. A sub-plot to the Timoshenko-Yushchenko tension has been Ms Timoshenko's rivalry with Petro Poroshenko, a businessman-politician who wanted to be prime minister but became head of the national security and defence council instead.

Parliamentary elections next March are exacerbating tendencies to populism. Under a reform agreed last December, some powers are due to shift from president to parliament and prime minister, though this change may yet be repudiated. After the elections, will the president and—if she is still in office—Ms Timoshenko learn from their mistakes and vindicate the orange revolution? Both remain popular. And Ukrainians have learnt to be patient. But Mr Yushchenko must be steelier if he is to overcome the corrupt, fractious pathologies of Ukrainian politics.

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Poland and Belarus

Bordering on madness

Jun 16th 2005
From The Economist print edition

Belarus mistreats its Polish minority

Get article background

A FORGOTTEN minority in a neglected country, the 500,000-odd Poles living in benighted, autocratic Belarus have rarely troubled the outside world. Until now. Alexander Lukashenka, the country's erratic leader, has made the Poles into new targets for his intolerance of internal dissent and outside interference.

The western half of Belarus was in pre-war Poland. The booming economy and lively democracy across the border now stand in contrast to the poverty and repression of Belarus since 1994, when Mr Lukashenka won the last freely contested presidential election. The Belarussian authorities believe that their pro-western neighbours are trying to topple the regime, and see the Polish minority as a fifth column. In the past month, they have expelled a Polish diplomat, closed a Polish-language newspaper and replaced the democratically elected leadership of a local Polish organisation, the Union of Poles in Belarus (UPB), with their own nominees. This week a mysterious pirate edition of the UPB newspaper came out, praising the Belarussian authorities.

The government is keeping a close eye on its neighbours. Pro-democracy outfits find it hard to work in Belarus, so they are usually based nearby, often with foreign funding. Belarus's main independent university, closed last year, has reopened in Lithuania. But the Belarussian KGB—as it is still called—believes worse is going on. “Camps for the training of militants, who will take part in clashes with Belarussian law enforcers and will destabilise the situation in the country, are being set up in neighbouring states,” its chief said in May.

The Poles have been singled out, but they are not the only ones suffering. The regime has launched a crackdown on the country's fragmented and ineffective domestic opposition, most of whose leaders are in jail or in exile. The remains of the free press in Belarus face potentially crippling lawsuits. All this is making Belarus a political issue in Poland, in the run-up to its general election in September. Some Polish politicians want to step up pro-democracy broadcasts to their eastern neighbour. But a senior Ukrainian official, Oleksandr Zinchenko, said in London recently that his country would not take part in such a plan.

It is hard to read Belarus. The regime survives thanks mainly to cheap Russian energy—but also flirts vigorously with China. It seems to be a dictatorship—but officials semi-privately hint at their distaste for their leader's antics. One opposition figure, a former diplomat named Mikhail Marynich, is expected to be

released from jail next month, after western lobbying. The opposition is strongly pro-western—but many Belarussians still feel close ties with Russia.

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Germany's left

Cold fusion

Jun 16th 2005 | BERLIN
From The Economist print edition

A new left-wing party could upset the political apple cart in September

Get article background

CAN Germany's socialists unite? Eastern Germany's former communists (the Party of Democratic Socialism, or PDS) and a largely western-based left-wing party (Alternative Labour and Social Justice, or WASG) have agreed to stand together in the general election expected on September 18th. The new group, which after much argument has chosen the name Democratic Left-PDS, has a good chance of crossing the 5% threshold for parliamentary representation. So it could affect the formation of a new government. And yet it may not become a permanent fixture in the German political landscape.

The east-west pairing seems a good fit. The two parties largely agree, especially on what they dislike: "neo-liberal" thinking in general, and the reforms of Chancellor Gerhard Schröder in particular. And their top candidates' star power will all but guarantee a respectable vote. Gregor Gysi and Oskar Lafontaine are, respectively, the darling of the former communist left, and Mr Schröder's former arch-rival within the Social Democrats (SPD).

Mr Gysi and Mr Lafontaine are surprisingly similar. Both are populists who cut a dash on the talk-show circuit. Both have a history of chickening out when the going gets tough: Mr Gysi resigned as economics minister of Berlin, Mr Lafontaine quit as Mr Schröder's first finance minister. Both are noted *bon vivants*. And both have had near-death experiences: Mr Gysi has had two heart attacks and brain surgery, Mr Lafontaine was once attacked with a knife by a mentally sick woman.

Much has to be settled, not least the Democratic Left's programme and how to put together regional election lists. Because German electoral law does not allow two parties simply to combine their lists (they could otherwise circumvent the 5% threshold), and because there is no time for a formal merger, WASG candidates will have to run on the PDS lists.

In the end, the lure of parliamentary seats and cash (€0.85, or $1, per vote for parties with more than 0.5% of the total) should be enough for the two parties to overcome the barriers to fusion. Polls suggest that the Democratic Left could win 6-8% of the vote. That would make it a force to be reckoned with after September 18th, if the Christian Democrats (CDU) do not win enough seats to govern on their own. If the new party does well, the CDU and the Free Democrats may not even be able to form a "black-yellow" coalition. That just might push the CDU and the SPD into a "grand coalition". The important point is not that the Democratic Left will take votes from the SPD and the Greens, but that it may attract those who would otherwise not vote at all, which should increase the overall vote for the left, says Manfred Güllner of Forsa, a pollster.

Yet the longer-term question will be how long the marriage of convenience can last and whether the two parties manage a full merger within two years, as planned. Peter Lösche, a political scientist at Göttingen University, is sceptical. He says that, unlike the Greens, Germany's only successful new party since the war, the new group is not based on a dynamic social movement with a vision, but on a hotch-potch coalition seeking to defend the status quo. What is more, its membership is culturally incompatible: power-conscious ex-communists, idealistic trade unionists and disappointed Social Democrats. The bickering before a name was chosen for the new group may just be a foretaste of quarrels to come.

A lot will depend on how much room the SPD and Greens leave on the left. The SPD has already moved in this direction, calling for more regulation of hedge funds and higher wages, but it has stopped short of reneging on Mr Schröder's reforms. This may change after the election, when younger, more left-wing elements could take over. The Greens, too, are inching leftwards, since they could suffer, as a share of

their votes, even more from defections to the new grouping.

In one way, it could be good if the Democratic Left has some long-term success. For this could keep disaffected voters from backing another party in years to come: the neo-Nazi National Democrats (NPD). Although the NPD has united several groups on the extreme right, the election in September comes too early, since it has taken real root only in parts of eastern Germany. But if the economy does not improve, its time may yet come.

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The European Union budget

About a rebate

Jun 16th 2005
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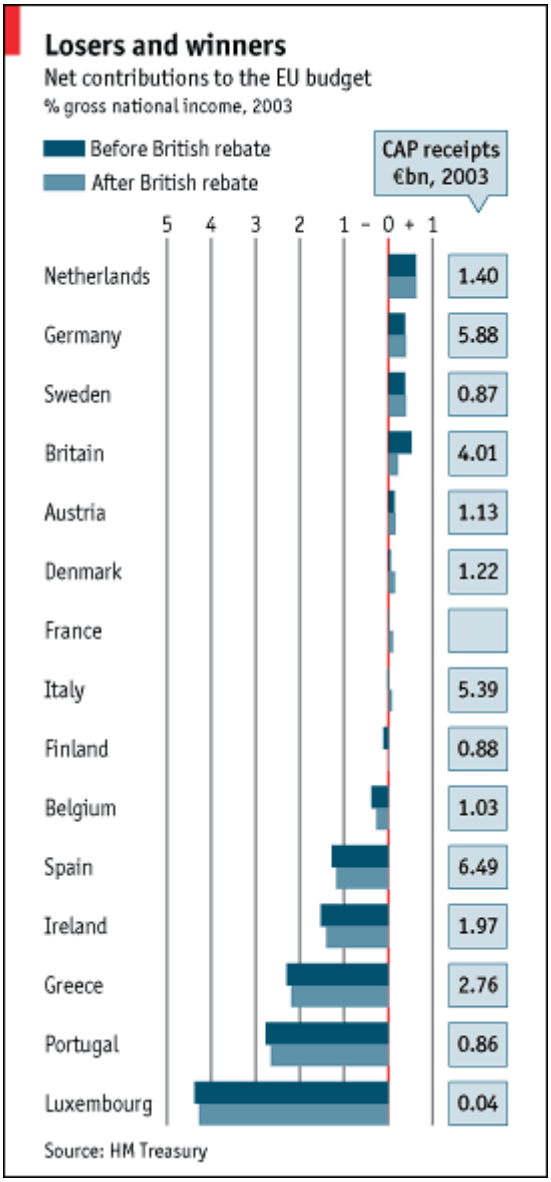
A bluffer's guide to the European summit's squabble over the budget



THE EU summit on June 16th-17th was bound to be fraught, because it followed the French and Dutch referendums that decisively rejected the EU constitution. But France's president, Jacques Chirac, then cleverly changed the subject, by demanding that Britain make a “gesture of solidarity towards Europe”—and give up most of its budget rebate. The summit, which began after *The Economist* went to press, looks highly unlikely to agree on the budget. But it is worth asking why the rebate suddenly became so contentious.

The EU budget, at just over €100 billion ($120 billion) is quite small (around 1% of EU GDP). But because almost half goes on the common agricultural policy (CAP) and a third on regional aid, it gives rise to widely different net contributions and receipts. In 1979, when it became clear that Britain, which because of its small farming sector gets few CAP receipts, would be the biggest net contributor, Margaret

Thatcher asked for Britain's money back. Several bad-tempered summits later, she got it. Ever since, the European Commission has calculated (roughly) the gap between what Britain pays in and what it gets out every year, and handed back a rebate of 66% of that gap, paid a year in arrears.

The chart shows net transfers, before and after the rebate, for the 15 EU members in 2003, as shares of national income, along with each country's CAP receipts. Even after the rebate, Britain is the fourth-biggest net contributor by shares of national income. In cash, it is the second-biggest after Germany. Hence Tony Blair's retort to Mr Chirac, that “Britain has been making a gesture because over the past ten years, even with the British rebate, we have been making a contribution into Europe two and a half times that of France.”

Mr Chirac's real worry is that the rebate is growing, and that France pays disproportionately towards financing it (under a special deal, Germany, Sweden, Austria and the Netherlands pay only one-quarter of their normal share of the rebate's cost). Commission forecasts show that, by 2013, Britain's net contribution might even—*quelle horreur!*—fall below France's. Britain is exploring with the ten new members how to refund their share of the rebate, a suggestion also made this week by Peter Mandelson, the British commissioner. Yet Mr Blair has a grievance too: that the budget negotiations, which are meant to set spending ceilings from 2007 to 2013, have omitted the biggest item: the CAP.

That is because, in October 2002, Mr Chirac got first Germany's Gerhard Schröder and then other EU leaders to agree to keep CAP spending unchanged until 2013. About a quarter of CAP spending goes to France: that €10 billion-plus every year is worth two and a half times as much as the British rebate. No wonder Mr Chirac, who cut his teeth as a farm minister fighting for the CAP, is so eager to protect what some British officials disdainfully term the “French rebate”. And no wonder Mr Blair will not discuss his own rebate unless the CAP, the main cause of Britain's budgetary burden, is also discussed.

Why has the row broken out now? The EU must agree, unanimously, a budget for 2007-13. Yet it need not do this until early 2006, when the commission draws up a budget for 2007. It is hard not to conclude that Mr Chirac ambushed Mr Blair mainly to divert attention from France's *non*.

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Spain and its regions

Homage to Barcelona

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From The Economist print edition

Catalonia could be more of a challenge to Madrid than the Basque region

Get article background

SPAIN'S richest region, Catalonia, is normally a sensible enough place. But its politicians may not be. On a recent trip to Israel, Josep Lluís Carod-Rovira, leader of the nationalist Catalan Republican Left (ERC), boycotted a wreath-laying at the tomb of Yitzhak Rabin because no Catalan flag was flying. He also called on Catalans not to back Madrid's bid for the 2012 Olympics, triggering a slump in sales of cava (Catalan sparkling wine) in the Spanish capital. Then there was the plea by Pasqual Maragall, Catalonia's Socialist premier (who is in coalition with Mr Carod-Rovira), for France to take Catalonia into the club for French-speaking countries. That riled Castilians—as did plans to ban bullfighting in Barcelona.

Underlying such friction is Catalonia's desire for a new constitutional statute giving it more autonomy. Spain's Socialist prime minister, José Luis Rodríguez Zapatero, has agreed to consider this, if only to respond to Catalonia's complaints about paying far more into the national kitty than it takes out. Mr Maragall also backs demands that Catalonia be recognised as “a nation”. After all, Valencia, governed by the centre-right, has adopted a new constitutional statute referring to its region's “historic nationality”. Yet the right frets that a weak Socialist-led government, dependent on regional nationalists, could endanger Spain's much-prized unity.

Mr Zapatero is already under fire for offering to talk to the Basque terrorist group, ETA, if it renounces violence. Catalonia, with a population of almost 7m and one-fifth of Spain's GDP, matters more. The 1978 constitution gave it plenty of autonomy, and the offer of more has emboldened other regions. A survey by *El País* found that 11 of Spain's 17 regions want more autonomy. Even some Socialists are unhappy about this. The Socialist leader of Extremadura, Juan Carlos Rodríguez Ibarra, and the defence minister, José Bono, have both attacked Mr Maragall. Mr Ibarra took umbrage at Catalans' claims that they subsidised poorer regions, telling them to “stick the cash where it fits”. The government promises not to give Catalonia a financial deal that is not available to, and backed by, other regions.

Mr Maragall dismisses talk of a crisis. He decries Spain's political culture, wedged between a centrist right and nationalists who cannot accept the pluralist reality of Spain. Will Mr Zapatero turn down Catalonia's new statute? “He will never say no. That is why he is so well considered here. He understands the plural reality of Spain,” says Mr Maragall. He does not want an independent Catalonia, but he points to growing acceptance of federalism. A recent article in *El País*, by its former editor, Juan Luis Cebrián, called on Spaniards to overcome fears of the word “federal”. “The statute does not have to be particular,” says Mr Maragall, adding that “the word nation is polysemic”. But like any good Catalan, he seeks more control of money. He wants to collect all taxes and pay Madrid only for central services, plus a small amount for other regions.

Some Catalan nationalists might accept federalism, though Basque nationalists want a “free state” associated with Spain. If Mr Carod-Rovira has his way, Catalonia will be independent in 15 years. But even he says this is not a priority. Demonised by the right for having once spoken to ETA, Mr Carod-Rovira is now a regular interlocutor of the government in Madrid. He thinks Catalonia is on a journey to independence, and he is using the Socialists to get there. Mr Maragall, well versed in the ambiguous language of regional nationalism, is relaxed. “They [the nationalists] can be seduced,” he says.

Mr Zapatero's overtures to ETA may well fail, after recent ETA bombings. But it is Catalonia that will really test whether, for all his fondness for dialogue and negotiation, Mr Zapatero has, as Spaniards like to say, the trousers for the job.

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Italy's fertility referendum

Score one for the Vatican

Jun 16th 2005 | ROME
From The Economist print edition

Italians obey their church's orders and stay away

Get article background

THEY did not get a vote on the European Union constitution. But Italians were called to the polls last weekend, for a referendum on whether to abrogate parts of a fertility law enacted in 2004 that banned research using stem cells from embryos, and imposed stringent requirements on test-tube pregnancies.

To succeed, the vote needed not just a simple majority but also a quorum of 50% of eligible voters. Yet, urged on by the new pope, Benedict XVI, Italy's bishops and priests told the faithful to boycott the referendum. Although almost 90% of those who went to the polls voted to change the law, only 26% of those eligible bothered to turn out.

This means more than just leaving the law unchanged. It showed Italians' obedience to the Vatican, which interfered directly in the vote, as well as their political apathy. Even Italy's second- and third-highest office-holders, the speakers of the Senate and the Chamber of Deputies, encouraged people not to vote. In contrast, Carlo Azeglio Ciampi, Italy's president, set an example by voting.

Apart from the politicians who supported the referendum, most but not all on the left, there are several other losers. One is the referendum mechanism itself. None of the six referendums held in the past decade has reached a quorum. Ballot-box secrecy also received a bashing; parish priests in rural areas could quite easily identify those who voted. Poorer Italians unable to have children save by *in vitro* methods that might not work will be losers—the rich will easily be able travel to neighbouring European countries that have more liberal laws on fertility treatment.

Science is a loser as well. Italy purports to want to attract investment in life sciences. But as Susanna Agostini, head of the health and social-services commission in Florence, put it, “the law and the campaign against its abolition attack science and obstruct progress.” Supporters of the referendum now fear there might be a church-led assault on Italy's abortion law. The secular nature of a republic in which law-making and the church are separated was another loser.

The clear winners were Italian apathy, both on fertility laws and over referendums—and the church. Theocracy may be far off in Italy, but by following the Vatican's wishes, Italians showed once again the power of their church.

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Charlemagne

Re-enacting Waterloo

Jun 16th 2005
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The uncanny parallels between a summit and a battle

THIS weekend enthusiasts from all over Europe will gather in the fields round Waterloo, a few miles south of Brussels, to re-enact the great battle fought on June 18th 1815, exactly 190 years ago. Assorted men in period uniforms, accompanied by cannons and cavalry, will descend on the scene of the fighting. French and British participants in such re-enactments emphasise that it is all done in a spirit of mutual good fellowship, and that it does not reflect any lingering desire to blow each other to bits with muskets. But anybody who really believes that Anglo-French antagonism can now be safely consigned to history should perhaps avert their gaze from the European Union summit, which will just be concluding up the road in Brussels.

For at that summit, another Anglo-French battle looms. The role of Napoleon will be played by Jacques Chirac of France; Tony Blair is cast as Wellington. Like Napoleon before Waterloo, Mr Chirac does not arrive in Brussels in good shape. But whereas Napoleon was troubled by cystitis and haemorrhoids on the eve of the battle, the French leader is afflicted by nothing worse than a nasty dose of political humiliation, after his failure to persuade French voters to say yes to the EU constitution in their referendum on May 29th. At least Mr Chirac has reacted to adversity in true Napoleonic fashion, by going on the attack.

First he has appointed a dashing new prime minister, Dominique de Villepin, who is such a fan of Napoleon that he keeps a bust of the emperor in his office. Next, in the week before the summit, Mr Chirac launched an all-out offensive against *le chèque Britannique*—the rebate that Britain gets on its net contribution to the EU budget. The president has chosen his ground skilfully. By focusing European discussion on the rebate, he has ensured that it is Britain rather than France that goes into the summit looking isolated and on the defensive.

If Mr Chirac's tactics have a dash of Napoleon about them, Mr Blair makes a rather less convincing Wellington. After meeting the French president in Paris this week, Mr Blair was at pains to emphasise that, despite their disagreements, the discussions had been “immensely amicable”. This is a rather different tone from that adopted by the Iron Duke, who once remarked that “we always have been, we are, and I hope that we always shall be, detested in France.” Nonetheless, faced with Mr Chirac's pre-summit offensive, Mr Blair has been forced to adopt Wellington's tactics at Waterloo: the obdurate defence of a red line. The British rebate, he has repeated over and over again, will not be surrendered, no matter how many crazed charges the French mount against it.

Just as in 1815, both France and Britain are casting around Europe for allies. Mr de Villepin notes, in his book on the “hundred days” before Waterloo, that the emperor's *Grande Armée* was a pan-European force of many nationalities. Wellington too had to rally supporters from all over Europe to stop Napoleon: at Waterloo, only about a third of the troops under his command were actually British. However, the alliances have shifted a little over the past 190 years. In 1815 some of Napoleon's crack troops were Polish. These days the French live in terror of armies of Polish plumbers invading their country and laying waste to the French social model. And the Prussians seem to have changed sides. At Waterloo, Wellington was saved by the late arrival on the battlefield of Marshal Blücher. In Brussels this weekend, Gerhard Schröder of Germany (admittedly a Saxon, not a Prussian) will be firmly in the French camp.

Yet the British might, even so, be helped by the late arrival of Prussian reinforcements. Mr Blair may have got no change out of Mr Schröder in his pre-summit visit to Berlin, but Angela Merkel, leader of the German Christian Democrat opposition (and a Prussian), sounded considerably more sympathetic to the British view that the rebate was justified because of excessive EU subsidies to French farmers. Since Mrs Merkel may well replace Mr Schröder as chancellor after the German elections that are likely in

September, Mr Blair has a clear motive to ensure that this week's summit is but a preliminary skirmish. If he can delay the main confrontation until later in the year, he may find that Marshal Merkel belatedly rides to the rescue.

A British tactic of defence and delay is even more likely given the broader coalition of forces taking shape in Europe. If the British can shift the debate away from the vexed question of the rebate, they could find themselves on more favourable terrain. Not only is Mr Chirac's love of farm subsidies mistrusted in much of the rest of Europe; so is his desire to export the French social model, which is not wanted in the EU's newer members.

A wider world

Atavistic Anglo-French antagonism seems sure to loom large at the summit. But both sides could usefully remind themselves that things have changed a bit over the past couple of centuries. In 1815, the fate not just of Europe, but of the world, hinged on the battle of Waterloo. Today the victor in any intra-European rivalry can no longer lay claim to global leadership. To the Americans or the Chinese, the EU's internal struggles are as incomprehensible and irrelevant as the arguments of warring tribes on the edge of his empire might have been for Napoleon.

Although it was tactically smart for Mr Chirac to pick a fight with the British in the wake of his referendum defeat, it was also a strategic mistake. The EU is already divided; the last thing it needs is a new source of rancour. Mario Monti, a former European commissioner from Italy, was being melodramatic when he spoke recently of a divided Europe ending up as “a suburb of Shanghai”. But it is surely true that the EU, struggling as it is with relative economic (and, even more worrying, demographic) decline, can ill afford yet more internal disputes. In short, it may at last be time for the British and French leaders to stop re-enacting the battle of Waterloo.

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The media and the internet

Old news and a new contender

Jun 16th 2005
From The Economist print edition

Alamy

The BBC's excellent websites may make it even harder for newspapers to survive

THE BBC, Britain's mammoth public-service broadcaster, has long been a cause for complaint among its competitors in television, radio and educational and magazine publishers. Newspapers, meanwhile, have been protected from it because they published in a different medium.

That's no longer the case. The internet has brought the BBC and newspapers in direct competition—and the BBC looks like coming off best.

The improbable success online of Britain's lumbering giant of a public-service broadcaster is largely down to John Birt, a former director-general who “got” the internet before any of the other big men of British media. He launched the corporation's online operations in 1998, saying that the BBC would be a trusted guide for people bewildered by the variety of online services.

The BBC now has 525 sites. It spends £15m ($27m) a year on its news website and another £51m on others ranging from society and culture to science, nature and entertainment. But behind the websites are the vast newsgathering and programme-making resources, including over 5,000 journalists, funded by its annual £2.8 billion public subsidy.

For this year's Chelsea Flower Show, for instance, the BBC's gardening micro-site made it possible to zoom around each competing garden, watch an interview with the designer and click on “leaf hotspots” about individual plants. For this year's election, the news website offered a wealth of easy-to-use statistical detail on constituencies, voting patterns and polls. This week the BBC announced free downloads of several Beethoven symphonies performed by one of its five in-house orchestras. That particularly annoys newspapers, whose online sites sometimes offer free music downloads—but they have to pay the music industry for them.

It is the success of the BBC's news website that most troubles newspapers. Its audience has increased from 1.6m unique weekly users in 2000 to 7.8m in 2005; and its content has a breadth and depth that newspapers struggle to match.

Newspapers need to build up their online businesses because their offline businesses are flagging. Total newspaper readership has fallen by about 30% since 1990 and readers are getting older as young people increasingly get their news from other sources—principally the internet. In 1990, 38% of newspaper readers were under 35. By 2002, the figure had dropped to 31%.

Just this week, Dominic Lawson, the editor of the *Sunday Telegraph*, was sacked for failing to stem its decline. Some papers are having some success in building audiences online—the *Guardian*, which has by far the most successful newspaper site, gets nearly half as many weekly users as the BBC—but the problem is turning them into money.

The difficulty for all newspaper websites is that most of their visitors tend to stay only briefly, viewing just a few pages. That makes it tricky to build a subscription model. Aside from specialised content, such as crosswords, or business news on the *Financial Times*'s FT.com, newspapers offer their content free. As for internet advertising, most of it goes to the biggest sites, such as Google and Yahoo!

Still, some papers are covering their online costs. The *Guardian*'s site is on the brink of making money. FT.com broke even at the end of 2002, after lots of investment, and the *Daily Telegraph*'s site started paying its way from 2002 onwards. But if the papers' internet arms are to counterbalance the loss of revenue offline, they will have to start covering rather more than just their incremental costs.

Part of the papers' problem online is that they're papers: they don't understand moving pictures and graphics. The BBC's television background gives it a feel for what works well on the internet. And, crucially, it has far more journalists on tap than any newspaper. As the *Sun* website's night team of four people rushed to cover the result of Michael Jackson's child-abuse trial this week, its editor, Pete Picton, was dismayed to see how much the BBC was doing and with what resources. “They had a micro-site, journalists coming out of their ears, different angles and their own video footage,” he says. “We can't compete with their breadth of material.”

Competition from the BBC does not just reduce traffic on the newspapers' sites and the amount of cash they can earn from advertising. Taking people away from news also stops newspapers luring people into other areas of their sites such as personal finance, or classifieds, which have higher value for advertisers and generate more revenue, says Simon Waldman, head of digital publishing at the *Guardian*.

Richard Deverell, head of BBC News Interactive, argues that newspapers face such difficult challenges both online and off that the BBC is not a big factor. The BBC is making an effort to link its pages to other news organisations, he points out, both in Britain and abroad (depending on the subject) which in the past it did not.

That change comes as the result of a review last year of the BBC's website by Philip Graf, a former boss of Trinity Mirror, a newspaper company, who concluded that the BBC was somewhat out of control online. Mr Graf admitted that he could not prove that the BBC's online services damage its competitors. Nevertheless, he says, “there is no doubt that the BBC's well-funded presence is very strong competition for newspapers on the internet.”

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Stonehenge

Prehistoric planning

Jun 16th 2005 | SALISBURY PLAIN, WILTSHIRE
From The Economist print edition

How a monument got trapped between the government and the druids

STONEHENGE, a collection of stones on Salisbury Plain that work like a giant calendar to mark the longest and shortest days of the year, is Britain's most important prehistoric site. No one really knows why it was built, but its peculiar fascination reaches its peak next week, when around 20,000 people will turn up to celebrate the summer solstice.

The druids, pagans, astrologers and revellers may be too excited about being let near the stones, which they were banned from up until a few years ago, to care much about the shabbiness of the site. But for the 800,000 tourists who visit every year, the experience is awful.

The problems start with traffic noise from the two A-roads that border the stones, interrupting serious contemplation of planetary movements. Stonehenge is so close to the busy A303 that it resembles a prehistoric petrol station. From the north side of the monument, the visitor can see the tops of lorries sailing between the upright stones. Visitors are provided with a cramped car park and a visitor centre made up of a handful of green Portakabin-like buildings. Then they have to walk to the site through a grim concrete subway.

English Heritage, a government-funded agency that has responsibility for the site, has long wanted to make visits to Stonehenge nicer. When it was set up in 1984, it said that improving Stonehenge would be its priority. Twenty years later, the latest version of the plans include an overland train that would bring tourists from a car park 25 minutes away, a visitor centre costing £57m and a plan to hide the nearby road in a tunnel. But those plans haven't got anywhere either, to the frustration of Sir Neil Cossons, English Heritage's current chief executive.

The scheme is being held back by two drawn-out and expensive planning inquiries. Salisbury District Council is considering the application to build a visitor centre, while the Highways Agency, the government agency that handles road-building, is considering the plan to bury the road. And the planning process in Britain is both open and arbitrary: public inquiries are held, but may not actually determine what happens. They can also take a long time: the public inquiry held by the Highways Agency began in 2003 and is yet to make a decision. These delays increase costs.

In addition to this, the druids are determined to make sure that the Highways Agency chooses to dig a proper tunnel (which is expensive), rather than just sinking the road and putting a roof on top of it, which would disturb more of the archaeologically interesting plain. King Arthur Pendragon, a druid king and pagan priest who boasts that he was arrested 30 times while protesting against the building of a road to bypass Newbury, promises “the biggest protest in Europe” if the government takes the cheap option.

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Chinese tourists

Footfall

Jun 16th 2005 | BICESTER, OXFORDSHIRE
From The Economist print edition

An early indication of what Chinese tourists like about Britain

JAPANESE tourists bearing credit cards loaded with yen transformed the fortunes of British tourism in the 1980s, and also rescued a handful of rather fusty British luxury brands. So the arrival of a new supply of Asian tourists, this time from China, is arousing some excitement. At the moment, Chinese visitors can travel to Britain only on business or student visas. But from the end of July, they will be allowed to visit Britain as tourists, thanks to an agreement signed by the British and Chinese governments earlier this year.

What might these people want to do when they are here? An early and rather bizarre indication came this week, when a group of 2,000 door-to-door salespeople who hawk Amway household cleaning products in China were brought to Britain as a reward for flogging exceptional quantities of bottles containing stuff for cleaning sinks. They were not on tourist visas, but their itinerary—London, Oxford, shopping—was more like that of tourists than of the wealthy businessmen and cash-strapped students who can already visit.

The trip took 700 of them to Bicester Village, a collection of designer-outlet stores near Oxford. Though many of the most expensive fashion brands have shops at Bicester, the only place where it was difficult to get through the door was Clarks, makers of frumpy but sensible shoes for British adults and schoolchildren. Some of the shoppers were filling suitcases with the shoes. During a previous Amway visit, the store had to hire security guards to restrict entry to the store. Why the crush?

Oddly, Clarks shoes are apparently seen as luxury items in China. The company reckons that the brand, which has been around since 1825, may be helped by its lingering colonial associations. Its presence in Hong Kong when the Chinese market was opening up may also have allowed it to get its products into smart department stores before the competition: although many of the shoes are made in Guangdong, they are pricier there than in Bicester. Evidently much planning had gone into the shopping expedition: some shoppers brought pieces of string cut to the length of a friend's shoe to get the size right, others brought cardboard cut-outs of a child's foot.

The Britons present were bemused by this frenzy, but the incomprehension may be mutual. Market research by Visit Britain, a government agency, says that along with beautiful scenery and bits of castle, Chinese tourists coming to Britain expect to find friendly local people and delicious regional cooking.

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Christianity

Shades of black

Jun 16th 2005
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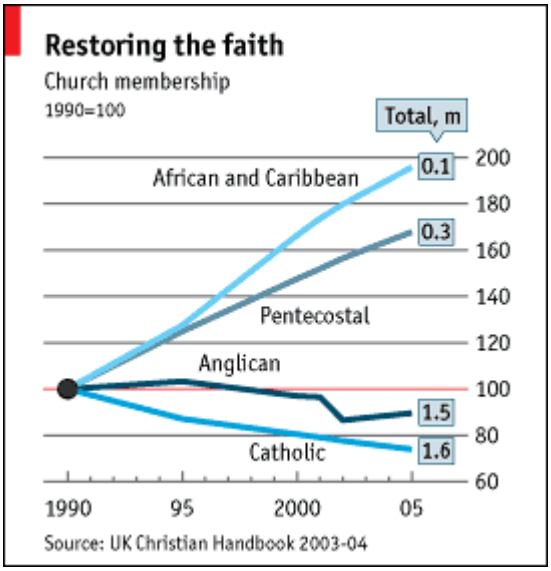
Black churches bring new life and new disagreements to British Christianity



WHEN Olu Abiola first came to England as a young preacher, he met lonely fellow Nigerians badly in need of succour who failed to get any from the one institution which might have provided a link with home—the church. In post-war Britain, Anglicanism was a largely white affair. This was especially hurtful for Olu, a member of the Church Missionary Society, one of the institutions that evangelised the colonies.

Half a century on, Father Olu Abiola OBE has a certain standing in London's religious scene. He left the Anglican church at the urging of Hugh Montefiore, a bishop whose Jewish origins and sharp, independent mind gave him some sympathy with outsiders. Father Olu is now the leader of an exuberant Aladura movement, made up of churches of African origin that put more emphasis on worship than theology.

At half a dozen places in London, his followers doff shoes and don white robes to pray and prophesy. These robes, a handout explains, are partly inspired by scripture and partly enjoined because “wearing white helps to avoid the distraction which might be caused by the colourful apparel of the better-off”. Father Olu is head of the Council of African and Afro-Caribbean Churches UK and a board member of Churches Together in Britain and Ireland, an umbrella group in which he sits alongside Anglicans. They now treat him more respectfully. Indeed, he says, some Anglican dignitaries have been amazed by his wife's gift of prophecy.

Not everybody in Britain's burgeoning black Christian community feels happy about the stamp of respectability which the Aladura movement has achieved. Among families who came to Britain from the Caribbean in the 1950s, the most dynamic religious groups are closer to mainstream evangelical Protestantism. Many belong to the Pentecostalist movement—the world's fastest-growing brand of Christianity. Such Christians tend to apply hard theological tests to any would-be partner: do they believe, for example, in atonement—the idea that Jesus paid for the sins of humanity by dying on the cross?

But the Aladura are structured and well-organised compared with a third category of black churches: new, wholly independent ones, often started by recent immigrants from Africa, whose only link with the church establishment may be their use of redundant Anglican buildings. It is in this shadowy area that

some abuses have occurred that deeply embarrass more respectable black Christians: cases of children being maltreated on grounds that they are witches, for instance.

Despite their differences, the black evangelicals and Pentecostalists have certain things in common with more informal movements like the Aladura. For one thing, they are growing and self-confident, while Anglicanism and Catholicism are shrinking and comparatively mild and emollient in their public statements. Moreover, the black churches have robust views on certain matters where the Anglican establishment tends to be benign and woolly, such as the newly published bill on outlawing religious hatred. The black evangelicals hate it, because they fear it threatens their right to proselytise.

Black evangelicals have also resisted proposals from Muslim groups for a “no proselytising” pact. As one leading black Pentecostalist puts it, “we believe that God brought us here from the Caribbean for a reason—to preach the Gospel not only among people of British origin but among fellow-newcomers to this country.”

But black immigrants are doing more to keep Christianity alive than starting new churches: they are also helping fill Anglican and Catholic pews which might otherwise be vacant. “I know several of our parishes which are kept going by black worshippers,” says a Catholic priest in central London. And there is speculation that John Sentamu, the Ugandan bishop of Birmingham, may soon be made Archbishop of York, the second office in the Church of England. As a man with much experience of being “stopped and searched” by the police, he will bring a new voice to a church which once brought English hymns to the empire's distant corners.

British Christianity has come a long way since the days of missionary paternalism. “Our white brothers and sisters keep asking us the secrets of our success,” says Bishop Joe Aldred, a Jamaican-born Pentecostalist. “We tell them it's because we are prepared to make sacrifices and stand firm on doctrine.”

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Ticket touts

Fair trade

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Instruments of economic efficiency or sick profiteers?

REGARDLESS of its musical or charitable merits, Bob Geldof's Live8 concert—which aims to “make poverty history”—gives a sharp lesson in the power of public relations. Sir Bob's saintly aura—and his less saintly vocabulary—have already wangled tax concessions from the Treasury; mobile phone firms waived their fees for the ticket lottery, conducted by text message.

When some lucky ticket winners tried to flog their prizes for a profit on eBay, an online auction house, Sir Bob accused them of “sick profiteering” and described eBay as an “electronic pimp”. The government soon joined in, with James Purnell, an ambitious junior minister, asking eBay to remove the items from its site. At first eBay protested, arguing that re-selling tickets is not illegal. But later that day it gave in, although it said that this was a one-off and that it would continue to allow re-selling in future.

Mr Purnell is not the only minister who thinks touts are bad. Re-selling football tickets has been illegal since 1994, mainly because of concerns about hooliganism. And although last year the Office of Fair Trading said that touts often benefited consumers, Tessa Jowell, the culture secretary, is now mulling the idea of extending the ban on touting to cover other sports, and concerts too.

The government's determination to align itself with Sir Bob is understandable: he is widely believed to be on the side of the angels and Tony Blair is not. Yet, given its much-publicised faith in market economics, it would be odd if the government decided in favour of legislating against people who are increasing economic efficiency by reallocating resources from those who value them little to those who value them a lot.

Sir Bob, at least, cannot be accused of intellectual inconsistency. The closest he has ever come to propounding an economic theory is the slogan of his Live Aid concert 20 years ago: “Give us your fucking money.”

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Pension bail-outs

Hazardous

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The government's pension insurer is taking equity in a troubled company. Is this a fresh form of nationalisation?

A NEW system to protect pensions in final-salary schemes started in April. The need for a safety-net was clear. An estimated 80,000 workers have incurred heavy losses on their pension rights after their firms folded. The total deficit in all private defined-benefit (DB) schemes in Britain is about £120 billion, according to Watson Wyatt, an actuarial consultancy.

One worry about the safety-net—the Pension Protection Fund (PPF)—is that it will be overwhelmed at its outset by early big claims. One expected for some time is likely to come from Turner & Newall, a failed engineering company. Its pension-fund hole will cost the PPF at least £225m according to John Ralfe, a pensions consultant; the bill could be much higher. This would be a substantial drain on the resources of the PPF, funded by a levy on private DB pension schemes.

But it is an unexpected claim that has caused alarm bells to ring. It has arisen from a controversial decision made by the Pensions Regulator, which plays a crucial role in the new pension-insurance system by seeking to ensure that as few cases as possible end up with the PPF. To secure this goal, it has been given general powers to strengthen the funding of DB pension schemes. It has also been given specific powers to stymie “moral hazard”—the risk that firms manipulate their affairs in order to offload pension liabilities on to the PPF.

An obvious way that moral hazard could occur is when companies merge or restructure their activities. For example, DB schemes in deficit could be shifted into one firm that is then allowed to go bust. In order not to stifle legitimate restructuring, plans can be submitted to the regulator for clearance. The regulator does not approve or veto transactions but it confirms whether or not they might trigger penalties under its moral-hazard powers.

This role in clearing deals seemed quite sensible until the regulator's first major decision, which was not about a viable company but one teetering on the edge of insolvency. Heath Lambert, once one of the world's biggest insurance brokers, has been in severe financial difficulties. It approached the regulator about a corporate restructuring that would allow it to carry on trading precisely because it could shed its pension-schemes deficit, valued at £210m, to the PPF. The regulator sanctioned a deal under which the PPF will assume the pension-fund debt and will take an equity stake in the new company, worth up to a third of it.

Defending his decision, David Norgrove, chairman of the Pensions Regulator, told *The Economist* that Heath Lambert's pension liabilities were going to land in the lap of the PPF one way or another. The PPF is better off with an equity stake in the new company than it would have been as an unsecured creditor if the insurance broker had become insolvent, in which case it would have got nothing. Furthermore, the regulator is obliged to take into account the effects on employment of its decisions when clearing deals. Heath Lambert employs 1,800 staff in Britain.

However, the case raises three worries. First, the deal lacks transparency. Its effect is to transfer a hefty slug of debt to the PPF that will have to be funded by pension-scheme members in solvent firms. Yet the regulator has made no formal statement about it. Mr Norgrove explains that the regulator is bound by legal obligations of confidentiality, but Nigel Waterson, a Conservative spokesman on pensions, says: “Once a deal has been concluded, it should be in the public domain.”

Second, the decision highlights a potential conflict of purpose, between the regulator's core obligation to protect the PPF and the requirement that it take jobs into account when clearing deals. “It is hard to see

how the regulator can satisfy both objectives at once," says Stephen Yeo, a partner at Watson Wyatt.

Third and most important, the decision seems likely to intensify moral hazard—the very reverse of what the regulator is seeking to achieve. The decision may indeed be the right one in the case of Heath Lambert, but it sends a signal to troubled companies with big pension-fund deficits that they may be able to avoid the trauma of bankruptcy. "This may be the least worst deal in this case, but the decision opens the door to moral hazards elsewhere," says Robin Ellison, chairman of the National Association of Pension Funds.

Mr Norgrove says that such decisions will occur rarely and that the regulator will not be a soft touch. But Mr Yeo says that a clear precedent has been set: "There must be other companies out there which will try to follow where Heath Lambert has led." It is hard to avoid the conclusion that the new system of pension protection has got off to an unfortunate start.

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Supermarkets

Indigestion

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From The Economist print edition

A big supermarket merger has gone badly wrong

Get article background

WHEN, in 2003, Wm Morrison, a small but profitable regional supermarket launched a £3 billion takeover bid for Safeway, a large but foundering outfit four times its size, it seemed a good idea for both parties. Morrisons would gain valuable retail space that would allow it to expand beyond its stronghold in the north of England. Safeway's shareholders would gain a stake in a profitable and growing company with a reputation for being efficiently run. Even the Competition Commission was bullish. After a year-long investigation, it bestowed its blessing on the new company in the belief that the deal would create a firm that could rival Tesco, Sainsbury's and ASDA, the dominant players in the grocery market.

But it hasn't happened. In July last year, three months after the merger was completed, Morrisons delivered the first profits warning in its 106-year history. Three more followed in quick succession until, at the firm's annual meeting in May, Sir Ken Morrison, the boss, admitted that he had no idea how much money, if any, his company was likely to make. That did not impress the shareholders, several of whom voted against Sir Ken's re-election to the board. The Financial Services Authority, the City regulator—understandably worried that a FTSE-100 company seemed to have little idea about its financial situation—prodded Morrisons until the firm released a fifth profits warning on June 8th. It hazarded a guess at profits of between £50m and £150m, compared with a combined figure of around £650m before the merger. After the costs of converting Safeway's stores into Morrisons' format, the firm could end up making a hefty loss.

Morrisons says that its problems stem from trying to integrate Safeway's back-office systems with its own. However, industry-watchers think there are other, bigger, problems. One, says Ben Britz, an analyst with Morgan Stanley, is that Morrisons simply assumed that what had worked for its stores in the past would work for Safeway's in the future, despite the fact that the companies were very different. Morrisons stores were all of a similar size; Safeway's ranged from small shops in city centres to giant suburban supermarkets. Morrisons' pricing model relied on selling everything as cheaply as possible; Safeway relied on promotional offers to drive sales. Nick Gladding, an analyst with Verdict Research, points out that even their customer bases were different: “Morrisons is a no-frills operator, whereas Safeway went for the aspirational customers,” he says.

The firm acknowledges that the takeover is proving tricky, but it insists that things will get better next year, by which time all of its stores will have been converted. Most analysts still think a recovery is possible. But Morrisons' rivals have sensed its weakness. In April, ASDA announced a new round of price cuts. Tesco followed suit a few days later. Those moves, combined with the general sense of gloom in the retail sector, do not bode well for Morrisons.

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Education

Tough choice

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The government is promising parents more choice but giving them less

Get article background

CHOICE is at the heart of the government's plans to reform public services. “Choice puts the levers in the hands of parents and patients so that they as citizens and consumers can be a driving force for improvement in their public services,” said Tony Blair last year. And he specifically pledged: “we want every parent to be able to choose a good secondary school.”

So one might expect that the new secondary school admissions system introduced in England this year would give parents more choice, and reduce the role of local education bureaucracies in allocating pupils to schools. Not a bit of it. The new system sharply reduces parents' chances of getting their child into the school they want.

Under the old system, parents applied to schools. It was a bit messy—some parents would make multiple applications, and keep lots of offers open, clogging the system up. The children of feckless parents ended up at the worst schools. But it seemed to work quite well. Research in 2001 showed that 96% of parents got a place at a school for which they had expressed a preference; 92% got their first choice and 85% got their favourite (not necessarily the same thing, because some good schools are so oversubscribed that parents don't even bother applying).

In the new system parents apply to their local authority, not to the school. Officials try to allocate places fairly—giving preferences to “looked-after” children (jargon for those in care homes). Where a school is oversubscribed, they apply criteria such as geographical proximity, or whether siblings are already at the school. In addition, around 1,000 schools are allowed to select some or all of their intake on grounds of academic ability or religious affiliation.

That's not a great deal simpler—and the already puny administrative abilities of some local education authorities have been taxed to breaking point by the task. One authority in East Anglia managed to lose all the forms relating to pupils with special needs, meaning that none of them got places. Schools say that appeals have rocketed.

The new scheme is supposed to be fairer. Under the old system, weak schools got more of what are known in education-speak as “challenging” pupils, making bad schools worse. But the new way of doing things seems to be reducing the number of poor children who get into good schools, which is presumably not what the government intended.

The Sutton Trust, a charity, points out that the new system discourages working-class parents from putting their children in for the best, oversubscribed, schools: if they fail to get into the school of their choice, they will end up at a sink school. Better, therefore, to put them in for a middling school. Ambitious middle-class parents, by contrast, are happy to give their first preference to the best local state school. If their child fails to get in, they can go private.

An example of this comes from Pate's, a selective school in Cheltenham. Sponsored by the Sutton Trust, it has been offering extra teaching and encouragement to boost the number of poor children applying from the locality. That is a worthy goal: at the 200 top-rated state schools nationally, poor children make up on average only 3% of the intake, showing the extent to which the middle classes have nobbled the best schools. Results were pleasing. The number of working-class children entering Pate's each year has risen from under six (out of 120 places) to 20.

But under the new regime, working-class applications have collapsed. Only four poor children will start this year. Even more perverse is who's benefiting. The number of Pate's entrants from fee-paying schools has doubled this year, to fully half the intake.

The Foundation and Aided Schools National Association, which represents most of the best-performing state schools, says this story is being repeated across the country. It is urging the government to reconsider the scheme for the year after next, by restoring direct application to schools while cutting the period in which parents can keep multiple applications open.

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About sponsorship

Bagehot

Doubts about Davis

Jun 16th 2005
From The Economist print edition

David Davis wants to lead the Tory party. He needs to be tested first

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HAVING decided at an ill-tempered meeting on June 15th to restore to themselves the sole right to elect their leader, Tory MPs will have no excuses if they get it wrong again. Some of them are still fuming about not having an election until after the party conference in October, but the timetable at least makes a proper contest more likely.

The possibility that David Davis might achieve such early momentum that nobody would think it worth their while to stand has thankfully receded: the problem now is that rather too many hats are flying into the ring. Mr Davis is a plausible candidate who has proved to be an effective shadow home secretary. With a well-organised campaign team around him, he is clearly, by some distance, the front-runner. But it would be odd and not entirely comforting for Tory prospects if someone who managed to garner the votes of just 18 of his parliamentary colleagues in 2001 should be elected unopposed only four years later.

There is a good deal to recommend Mr Davis, but there is also enough that should make Conservative MPs pause before leaping aboard what some fear may already be an unstoppable bandwagon. That Mr Davis should be in this position is not surprising. In many ways, he looks like an improvement on what has gone before. Unlike Michael Howard and William Hague, he doesn't talk in a funny way—he speaks the kind of demotic English that Tony Blair uses to such good effect. Unlike Mr Hague and Iain Duncan Smith, he is a tough and experienced operator who has prepared himself for the job over many years. Unlike the lost leader, Michael Portillo, he hungers to do it.

But being an improvement isn't enough—or at least it shouldn't be. To make themselves electable, the Tories need to do two things above all: come to terms with Blairism and, having done so, set a direction that they stick to even when it is uncomfortable to do so. What is worrying about Mr Davis is that he has not yet given any indication that he understands this. Perhaps that is because he feels that as the man to beat, the safest course is to stick to platitudes and give away as little as possible. On the basis of two recent interviews of numbing banality, that certainly appears to be his favoured course. But it may also be because he really doesn't understand it.

Mr Davis has, of course, made some nods in the right direction: uncontroversially, he acknowledges that the party's sour election campaign lacked a sufficiently positive vision of Britain; he mentions the poor; and he is keen to impress the liberal middle classes by opposing ID cards and other aspects of the government's casual approach to civil liberties. But this is offset by his apparent rejection of the need for the Tories to reoccupy the centre ground of British politics, where elections are usually won. Mr Davis seems to think that this would suggest a lack of faith in Tory principles that would compare unfavourably with the ideological confidence he remembers from the glory days of the 1980s. In doing so, he ignores the single most important reason for the Tories' electoral failure: how completely Mr Blair has changed what and where that centre ground is.

The crucial insight of Mr Davis's critics on the centre and left of the party is that by continuing to try to define itself against Mr Blair, the Conservative Party has paid a terrible price, ending up appearing either extreme or irrelevant. As David Willetts, shadow trade secretary and the most thoughtful of the possible contenders against Mr Davis, argues, Mr Blair's synthesis of economic efficiency and social justice is something that Tories should seek to improve on, not oppose. When Mr Davis says that he regards Blairism as an “ebbing tide” that Tories should not be panicked into chasing, he is making the mistake of confusing Mr Blair, who will not be around for much longer, with Blairism, which is very likely to be.

This leads to a further concern about Mr Davis. Although he makes some of the right noises now, so too did Michael Howard and William Hague when they took over as party leader. But when things became difficult, both quickly returned to their default setting, seeking comfort in the old tunes that are popular with Tory supporters but not much liked by anyone else. A critical question for those thinking of voting for Mr Davis therefore is this: what will his default setting be if things are not going his way. Unfortunately, this question is very hard to answer because even Mr Davis's shadow cabinet colleagues have only a vague idea what he really thinks.

Willetts or won't he?

At the very least, Mr Davis's ideas and his leadership credentials warrant the critical examination of a well-contested election. Whether they will get it is another matter.

Unfortunately, with the number of possible candidates entering double figures, it is proving difficult for anyone to break decisively out of the pack pursuing Mr Davis. It is virtually certain that David Cameron, the 38-year-old shadow education secretary, will run. He has the backing of Mr Howard, several other shadow cabinet members, the so-called Notting Hill set of youngish, metropolitan modernisers and some party benefactors. He is clever and sensible, but with only four years as an MP behind him, he may well be too inexperienced to go the distance against Mr Davis.

As Tim Yeo, who quit the shadow cabinet after the election, argued this week, there is probably room for only one other serious candidate from the party's progressive wing to carry the fight to Mr Davis. A pivotal figure in deciding who that might be will be Mr Willetts. He might run himself or throw his support behind someone else if he thinks they would have a better chance of challenging Mr Davis.

Whatever Mr Willetts decides, he needs to get a move on. In politics, momentum is all and Mr Davis still has most of it.

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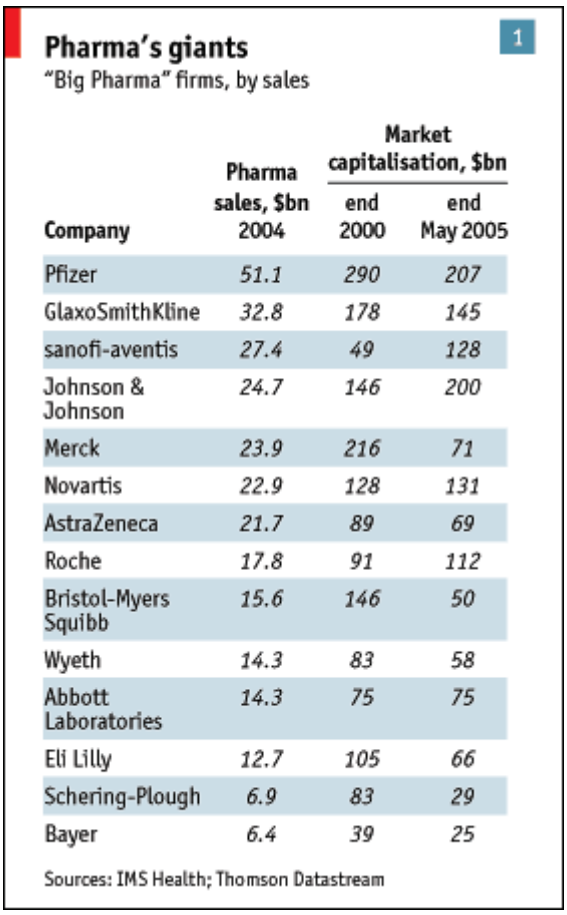
Prescription for change

Jun 16th 2005
From The Economist print edition

The pharmaceutical industry is ailing. Shereen El Feki (interviewed here) takes its pulse and predicts a partial recovery

AS A boy in the 1930s, your correspondent's father lived in fear of pneumococcal pneumonia. With good reason: one of his young friends had died of it. It caused coughing, chills and fever, leading to a crisis in which the patient either suddenly expired or miraculously recovered. Today, there are drugs to tip the balance in favour of survival, and a vaccine to prevent the disease altogether. But the pharmaceutical industry, which has been responsible for bringing such drugs to the market, is passing through its own crisis. Research and development (R&D) is spluttering, earnings have weakened, its public image is tarnished.



Pharma's giants 1

"Big Pharma" firms, by sales

Company	Pharma sales, $bn 2004	Market capitalisation, $bn end 2000	Market capitalisation, $bn end May 2005
Pfizer	51.1	290	207
GlaxoSmithKline	32.8	178	145
sanofi-aventis	27.4	49	128
Johnson & Johnson	24.7	146	200
Merck	23.9	216	71
Novartis	22.9	128	131
AstraZeneca	21.7	89	69
Roche	17.8	91	112
Bristol-Myers Squibb	15.6	146	50
Wyeth	14.3	83	58
Abbott Laboratories	14.3	75	75
Eli Lilly	12.7	105	66
Schering-Plough	6.9	83	29
Bayer	6.4	39	25

Sources: IMS Health; Thomson Datastream

This survey will examine the global drug industry, probe some of the patient's sorer spots and offer a diagnosis. Treatment is far trickier, but the following articles will suggest ways in which all those with an interest in its success—pill-makers and pill-takers—can hasten the recovery.

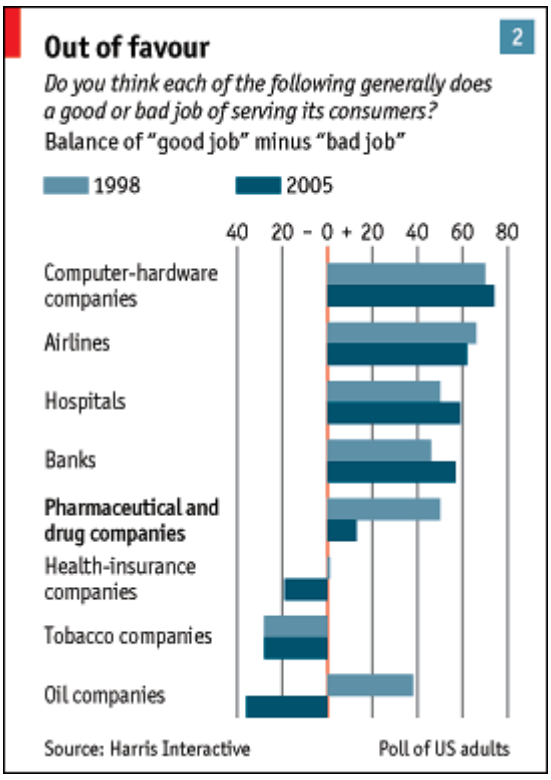
The global pharmaceutical industry consists of thousands of companies, including biotech firms, generic drugmakers, contract research organisations, wholesalers and retailers. On top of them all sits "Big Pharma"—a dozen or so multinational firms with headquarters in Europe or America (see table 1). Their sales account for roughly half of the world's $550 billion retail drug market. But the pharmaceutical industry is relatively fragmented, with the biggest company, Pfizer, holding less than 10% of the global market.

On the face of it, Big Pharma firms are in a business to die for. Populations in rich countries—and increasingly developing ones too—are getting older, and many people suffer from chronic conditions. Global drug sales have almost doubled since 1997, and will rise to more than $700 billion by 2008. By the standards of other industries, most big pharmaceutical companies are hugely profitable: operating margins are more than 25%, against 15% or so for consumer goods.

Tales of woe

But behind the healthy glow, a more worrying picture emerges. In the past few years large drug companies have had trouble getting new drugs out of their pipelines and into the market. At the same time, several high-profile medicines have been withdrawn because of safety concerns. Recently a whole group of drugs, anti-inflammatory medicines both old and new, have run into trouble. And several firms have suffered manufacturing problems.

Moreover, many so-called "blockbuster" drugs—those with more than $1 billion in global annual sales—have had their patents, and their market share, challenged by cheaper generic rivals. Over the next five years, a record $70 billion-worth of drugs will face generic competition in America alone. Drug-company sales, which increased by 10-15% a year for most of the 1990s, have slowed to single-digit growth. As a result, investors have shifted their attentions away from pharmaceutical firms, particularly in America, where drugmakers are currently in a worse state than their European peers.



The internal travails of the world's leading drugmakers have been compounded by a broader social debate about the purpose and practices of the industry, again mostly in America. This is the world's largest drug market, accounting for over 40% of global sales. American drug prices are largely set by the market, which has prompted pharma firms to invest there on a large scale. As a result, they have become a highly visible target for criticism. Europeans are far less exercised about the industry, in part because their drug bills are paid for mainly by their governments, and in part because they are shielded from pharmaceutical marketing.

Last year, health-care spending in America reached an estimated $1.8 trillion, more than 15% of GDP. Some $200 billion of that went on prescription drugs. Despite this enormous expenditure, large numbers of Americans are becoming increasingly frustrated about the state of health care in their country. Many elderly people struggle to pay for their drugs (although from next year they will get a helping hand from the government), big companies complain about their medical bills, and 45m people lack health insurance. Over the years, this frustration has in turn been vented on doctors, managed-care companies and hospitals; now it is the drug companies' turn, their public standing having fallen as precipitously (see chart 2) as their share price.

The drugmakers' dilemma

Why this anger at companies in the business of making life-enhancing medicines? The following excerpts from a report on congressional hearings in America neatly summarise the case against and for Big Pharma in turn:

> It has been argued that the drug industry derived a higher rate of return on its investment than other American industries. It has been argued that the pharmaceutical companies have at times exaggerated in their claims for the therapeutic value of certain drugs. It has been argued that the drug companies have spent an unreasonable portion of their budgets in order to indoctrinate doctors so that they would prescribe high-priced trade-marked products.
>
> The drug industry is a success story. But success cannot be accomplished through miracles. Unless the drug industry was given an opportunity to reap the harvests of its successes and to invest large portions of it in the development of its facilities and its research, this phenomenal success would not have been possible. Without the profit motive, and without the profits being reinvested in the industry, the state of the American pharmaceutical industry today would not be what it is.

How true. Pharma profits are both a blessing and a curse. Many people feel uncomfortable with the idea

of money being made from medicine, even when it is the price to be paid for innovation and better health. Pharmaceutical firms are not the only ones to make a handsome living out of health care, but they do so more conspicuously than others. Few patients know how much their doctor earns, or what a hospital is charging. But Americans blame high drug prices on Big Pharma's appetite for profits. Senator Edward Kennedy, a long-time critic of the industry, has a simple formula for categorising drug firms: he reckons that a third of them have the public interest at heart, a third are motivated by greed, and a third are somewhere in-between.

This is nothing new. Indeed, the congressional hearings quoted above took place back in 1960. The debate over pharma profits and practices has waxed and waned ever since. In the 1960s and 1970s, the first wave of blockbuster drugs for ulcers and high blood pressure came to market, drugs that treat—or even prevent—chronic conditions and are therefore taken for years. This was a fundamental change from an earlier generation of drugs that tackled acute ailments such as bacterial infections. The 1980s brought more new pharmaceuticals, for depression, cancer and nasty viruses, such as HIV.

By the early 1990s, the prospect of health-care reform and price controls in America brought gloomy predictions for the industry, but they turned out to be spectacularly wrong. Drugs that had been seen as modest earners, such as the cholesterol-lowering statins, became multi-billion-dollar blockbusters. Massive marketing campaigns lifted sales, and investors piled in as share prices rose ever higher. Firms flirted with all sorts of businesses before homing in on patented pharmaceuticals as the model for modern big drugmakers. The launch of a few high-profile drugs, such as Viagra and Lipitor, created the sense of an industry always on the verge of great scientific breakthroughs. And the growth of employer-sponsored health insurance provided a lot more money to pay for it all.

At the same time, white coats started to give way to dark suits in the boardroom as a new generation of CEOs from the commercial side of the business took over from scientists and doctors. Firms started to concentrate on hitting quarterly earnings forecasts, and mergers became a popular way to cut costs. Drugmakers began to spin out patents to stretch their sales, and became staunch advocates of strong intellectual-property rights at home and abroad. Existing drugs were tried out on different diseases, and more drugs of the same feather—so-called “me-too” medicines—poured out of the pipelines.

Much of the mess some of the big pharmaceutical companies have found themselves in over the past few years is a consequence of those heady days. The fruits of new science, such as bioinformatics and genomics, are only now starting to appear, later, as usual, than scientists had hoped for, and size has not helped the big pharmaceutical firms to excel at discovering new drugs.

Marketing practices are now under scrutiny, and drug companies stand accused of rushing drugs to market on the back of inadequate studies and withholding information about their drawbacks from patients and physicians. Drug companies have been slow to recognise that the traditional relationship between experts and the public has changed. Much of the public trust drugmakers enjoyed derived from the doctor-patient relationship, which is central to medicine. Yet that relationship too has changed over the past decade. If patients are prepared to question their doctors—sometimes prompted by pharmaceutical advertising—they are bound to start questioning the suppliers of their medicines too.

The cycle will in all likelihood turn again, and the bad press and gloomy investor sentiment will improve for a while. But drugmakers' essential dilemma will remain. As businesses, they are expected to innovate, take risks, compete vigorously and reap the rewards. But when they try to maximise shareholder returns, they run into trouble. If Kellogg wants to flood the airwaves with commercials to promote cornflakes for dinner, best of luck; but when Pfizer was trying Viagra for female sexual dysfunction, it was accused of inventing diseases to match its drugs.

A different kind of market

This illustrates the essential difficulty of bringing market forces into medicine. Health care does not work like a normal market, although there are ways of making it more market-like, such as shifting more purchasing power to patients and providing them with more information. But buying health care will never be like buying, say, a sports car, because a sick consumer is more constrained in his choice than a healthy one.

Some critics of the drug industry argue that drugmaking should be taken out of private hands and put in the public domain; after all, many of the basic discoveries that drug companies develop and profit from came from universities and government institutes in the first place. But there is little evidence that

governments or universities are any better than the private sector at bringing new drugs to market. The public may not like the way drug firms choose to spend their R&D dollars, or how they go about promoting their wares, but at least they have a record of bringing them to market in the first place.

Pressure from investors, buyers, regulators, doctors and patients is already forcing the world's leading drugmakers to question the way they do business. “The industry was living a little fat and happy,” says Sidney Taurel, Eli Lilly's boss. Many firms are now busy cutting costs. Some are diversifying away from primary care to specialist drugs, vaccines, generics or diagnostics. Some smaller companies may find themselves in mergers over the next few years. Some of the biggest firms might get smaller as they spin off some of their operations, perhaps even their core R&D. It will become harder to tar the whole industry with a Big Pharma brush.

Whatever the individual prospects of today's big drugmakers, there is no doubt that their products as a whole have a bright future. The next decade will see the emergence of many more drugs of many more kinds to treat many more ailments. Some of these drugs will come from unexpected sources. Most of them will offer small but steady improvements over what went before, and will enhance the quality of life for some but not all patients. But there will also be a few breakthrough products that will tackle disease in fundamentally different ways. For all this to happen, though, better ways will have to be found of valuing these medicines, not only in terms of what they cost but also of the savings they bring elsewhere.

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Testing times

Jun 16th 2005
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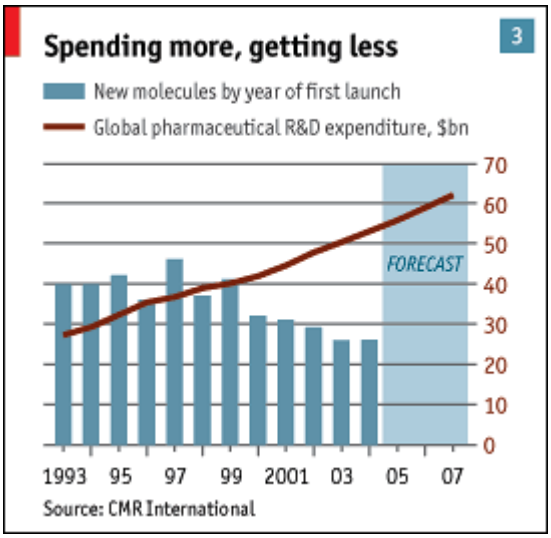
Getting more out of pharmaceutical R&D



R&D is the lifeblood of the pharmaceutical industry, but in the past few years many of the world's large pharmaceutical firms have been looking a little anaemic. The 1990s were a productive period, but more recently the number of new drugs launched on the global market has fallen dramatically (see chart 3).

The problem lies not just in the numbers of new drugs, but in how truly novel and useful they are. A few new drugs fighting disease in new ways have come to market since 2000, particularly cancer treatments. However, critics point out that only a third of the drugs launched on the market in the past few years were first or second “in class”. The rest were “me-too” medicines, tackling the same problem in much the same way as existing drugs.

Some drug-company bosses staunchly defend such drugs. They argue that the first product on the market is rarely the best, and that new entrants not only bring greater patient choice but also lower prices. “If everybody worked only on the high-risk, long-term projects, our investors would probably give up on us,” says Fred Hassan, boss of Schering-Plough.

Although output has been falling, drug companies have been increasing their R&D spending by about 6% a year since 1995, according to the Centre for Medicines Research International (CMR), to a forecast total of $55 billion by the end of this year, three-fifths of which came from big drugmakers. Given that it takes an average of 12 years to develop a drug from start to finish—depending on the nature of the molecule and the disease it tackles—the drugs coming to market today reflect the investments, and the science, of a decade ago. The big question is whether today's investments will yield better returns in the future. To answer that, it is necessary to understand why the output of drug companies has been declining, and what can be done about it.

Striking it rich in drug R&D is a chancy business. Drugs fall by the wayside at every stage: for every 10,000 molecules screened, an average of 250 enter pre-clinical testing, ten make it through to clinical trials and only one is approved by the regulator. Since the mid-1990s, average success rates have declined, most worryingly (because most expensively) at the later stages of clinical testing.

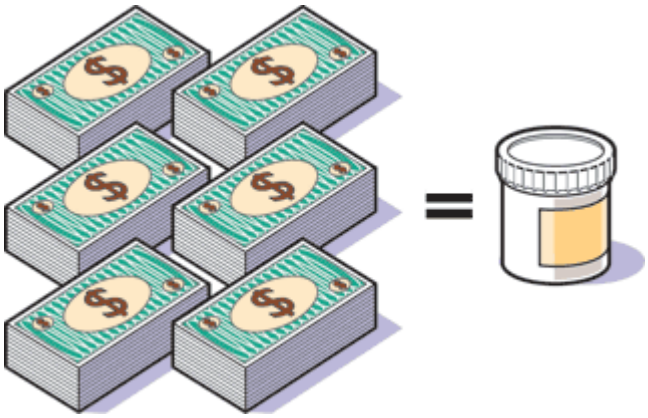
Stuart Walker, head of CMR, points to several reasons for the drop. Some of them are scientific: drugs that looked promising in preclinical development turn out either not to work or have unacceptable side-effects in clinical trials. Some of the problem, says Steven Paul, head of science and technology at Eli

Lilly, stems from companies putting compounds into late-stage clinical development prematurely to gain a higher profile with investors.

Some of the reasons are structural. A wave of mergers over the past decade caused upheaval in R&D operations. Other contributing factors are commercial. One-third of all molecules fail to make it through clinical trials because it becomes clear that they will not justify further investment. But one drugmaker's reject is another company's opportunity—and more big drugmakers are licensing out their molecules to smaller drugmakers or not-for-profit groups, or spinning out whole research teams into new companies. Iceland's deCODE genetics, for example, picked up a discontinued asthma drug from Bayer and has taken it through mid-stage clinical trials for heart attack.

The time it takes to bring a drug to market has increased, with the biggest rise in the clinical-trials phase. Drugmakers often argue that because of increasing demands for data by regulators, the size and duration of clinical trials has risen steeply, delaying the entry of drugs to the market and bumping up their R&D spending. Critics say that drugmakers bring these problems upon themselves by running lots of trials simply to collect more data for marketing later on. Both sides have a point.

The cost of drugmaking is also going up. A much-quoted figure for bringing a drug to market is $802m, calculated by Joseph DiMasi, an economist at the Tufts Centre for the Study of Drug Development. Mr DiMasi used confidential industry data from 1983 to 2000 for a selection of new drugs discovered and developed within big companies. The average out-of-pocket cost for these drugs was just over $400m; the rest represents the discounted opportunity cost of capital. Dr Paul at Eli Lilly says the cost of bringing a new drug to market has now risen to $1.5 billion; others put it even higher.



In most industries such figures on the cost of product development are of purely internal interest. In the pharmaceuticals business, however, they have become the subject of public debate because they are (incorrectly) linked to drug prices. A recent analysis by Christopher Adams and Van Brantner at America's Federal Trade Commission, using the same methodology as Mr DiMasi, came up with an even higher average, but found wide variations across companies and products: for example, the average HIV drug cost $479m to bring to market, but the average figure for rheumatoid arthritis was $936m.

Shot in the arm

Some drugmakers have been restructuring their R&D operations to boost their productivity, most dramatically GlaxoSmithKline (GSK), which says it has doubled its early-stage clinical pipeline as a result. But investors are still sceptical about the ability of the world's biggest drug companies to discover new medicines. Many think that they should concentrate instead on what they do best: late-stage development and marketing.

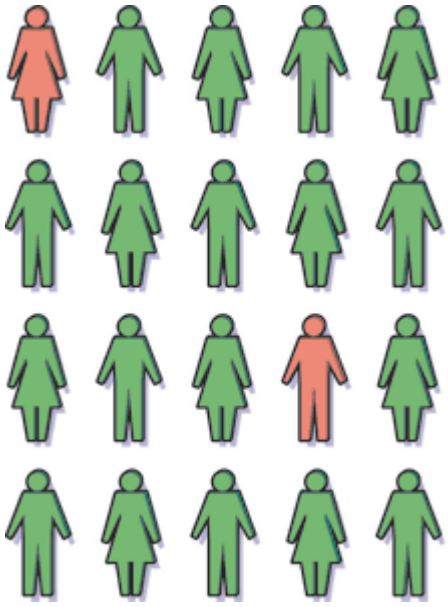
Certainly big drugmakers are looking to external sources of innovation. One-third of the molecules now in development originated in biotech companies. In-licensed molecules have had a higher chance of success in development in recent years because big drug companies tend to scrutinise these offerings more closely before bringing them in at a later stage of development.

But getting good bets is becoming harder and more costly as competition for molecules heats up, so big drugmakers are considering ever riskier projects. And a growing number of biotech firms are doing their own later-stage clinical development, regulatory submissions and sales.

Another route to more and better drugs lies in improving success rates. Until the 1990s, drug development focused on about 400 “druggable” molecules in the body that were known to be involved in diseases. The recent sequencing of the human genome has yielded thousands of potential new targets for researchers to try their molecules against; the problem is that it is proving much harder to “validate” these targets than researchers had hoped.

Drugmakers are looking for new technologies to help them predict a molecule's efficacy and toxicity as early as possible. One emerging tool among many is computer simulation, using software to model drug behaviour in a cell, tissue, organ or even population of patients in a much more sophisticated way than before, to improve the design of the real tests.

Novartis is trying another interesting tack: getting more information out of its early-stage clinical trials by using particular types of patients, rather than just healthy volunteers. For example, the firm has a new antibody drug to tackle IL-1, a protein involved in rheumatoid arthritis. To find out whether this drug affected the target, it turned to a patient with a rare disease called Muckle-Wells syndrome, in which too much IL-1 causes fevers, pain and migraines. The drug relieved her symptoms, showing that it affects IL-1 in the body, and at what dose.



Drugmakers are also pinning great hopes on biomarkers—biochemical or biological features that correlate with diseases and can therefore be used as a surrogate measure of efficacy or safety. For example, a widely used biomarker in the development of anti-retroviral medicines is viral load—the amount of HIV in the blood—because it is known to correlate with clinical outcomes, but is much faster and easier to measure than actual symptoms. Drugmakers would love to have reliable biomarkers for many more diseases.

To that end, companies are starting to talk about pitching in together. One new consortium is the Alzheimer's Disease Neuroimaging Initiative, which aims to test whether magnetic resonance imaging, blood markers, genetic profiling and neuropsychological testing can do a better job than existing methods of predicting the effect of drugs on early Alzheimer's disease.

Governments are keen to help clear the bottlenecks in drug development. The European Commission, having seen much of the continent's drug industry move its research money across the Atlantic, wants to help boost drug R&D at home. In America the National Institutes of Health and the Food and Drug Administration (FDA) have set up initiatives to push along drug discovery and development.

The personal touch

The sequencing of the human genome opened a new world of biomarkers. What if it were possible to tell by a person's genetic signature how they would respond to a particular drug? At the moment as many as half of all drugs do not work for the people who take them. Such pharmacogenomics could reduce the size and cost of clinical trials by allowing pharma firms to select the most suitable patients. In clinical practice, pharmacogenomic tests could lead to better use of drugs by matching subjects and treatment—the dream of “personalised medicine”.

But the reality is rather different. There are plenty of interesting genetic markers for scientists to look at; the difficulty lies in proving that they reliably correlate with clinical outcome. Jörg Reinhardt, head of pharmaceutical development at Novartis, says his company was testing one new drug in 20 different countries, using a genetic marker that had been shown to give a 60% response rate. But when the researchers tried to subdivide their patient populations by country, they found response rates ranged from 25% to 90%. Something more than genetics was at work.

All the same, pharmacogenomics is slowly making an impact. The latest addition to the pharmacogenomic toolkit is the AmpliChip from Roche, which screens people for mutations in genes known to affect drug metabolism to determine the best dosage. Steven Burrill, who heads an eponymous merchant bank specialising in life sciences, reckons that diagnostics will be transformed from the poor cousin of pharmaceuticals into the main moneyspinner, leaving conventional drugs as the “commodity chemicals of the future”.

A world of personalised medicine would mean changes for drugmakers as well as for patients. At present, all roads lead to Big Pharma because of the size and complexity of clinical trials and the muscle required for marketing a blockbuster primary-care drug. But if personalised medicine allowed smaller trials, and marketing to more targeted populations, drug companies may not have to be so big.

Before and after

Getting a drug to market is one thing; a growing problem is keeping it there. High-profile withdrawals, such as that of Vioxx, a pain-relief drug, and Tysabri, a treatment for multiple sclerosis, have highlighted the problem of drug safety. This has created difficulties for both the drug companies and drug regulators. America's FDA has been accused of soft-pedalling on pharmaceutical safety, drug labelling and advertising, and being in thrall to an industry that pays many of its bills to maintain the drug-approval process; but it staunchly denies accusations of regulatory capture, and is setting up its own drug-safety oversight board within the agency.

Some members of Congress are pushing for a new, independent agency responsible for monitoring and acting on drug-safety issues. Senator Charles Grassley, who is heading the move, thinks the FDA lacks the right culture for the task. But others fear that a separate agency will be so concerned with the risks of drugs that it will neglect their benefits.

The present system of clinical trials is designed to demonstrate the safety and efficacy of drugs before they come to market. To pick up side-effects that are rare or occur only after long-term use before a drug is approved, clinical trials would have to become even bigger and more expensive. Moreover, clinical trials take place in highly controlled conditions that are quite different from the rough-and-tumble of routine clinical practice.

The remedy is to collect better data about the safety of drugs already on the market from doctors, patients and drugmakers. Systematic trawling of massive databases held by government payers and private health insurers might also show up problems that individual doctors and patients might not necessarily associate with a particular drug.

Such signals would still need to be followed by structured trials in the marketplace. The world's leading drug regulators already ask drug companies to follow their medicines in the market with so-called “phase IV” studies to look at various aspects of safety and efficacy; agencies in Europe and Japan have greater powers than the FDA to enforce this.

Another option, says Thomas Lönngren, head of the European Medicines Agency, is “conditional approval”—allowing drugmakers to bring their products to market earlier but obliging them to do more intensive follow-up in a much smaller population until they have proven their safety and efficacy. This already happens with drugs for certain conditions, such as cancer, but could be applied more widely. Such a tool may come in useful, because there are signs that the R&D pipelines are starting to fill up again.

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Looking west

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Japan's drug industry is running hard to catch up

JAPAN is the world's second-largest pharmaceutical market, worth $58 billion last year, according to IMS Health, a research firm. A greying population means growing demand for medicines to treat chronic diseases. Generic-drug use is low, so drugs losing patent protection should be fairly safe from competition.

With their home markets straggling, western drugmakers are giving the Japanese market increased attention and now account for more than a third of pharmaceutical sales in Japan. But the place is not exactly a goldmine. First, Japan is one of those countries where drug prices fall rather than rise. Last year alone, the government cut prices by an average of 4%. Second, Japan's drug regulator still requires a lot of clinical testing in Japan of drugs already marketed in the West, which is time-consuming and expensive.

Japanese firms have so far largely relied on licensing western drugs, which is becoming harder because foreign firms like to sell them on their own. Japanese drugmakers have invested less in R&D than their western peers, and Hirotaka Yabuki, at the Boston Consulting Group, reckons that R&D productivity of top Japanese firms is a third lower than that of their western peers. Nor do Japan's drugmakers have much of a local biotech industry to turn to for innovation. Sales and marketing is not a strong point either: Japanese salesmen have to push many more types of drugs in a single call than do western ones.

Over the past two years, Japan's pharmaceutical industry has seen a wave of mergers that has created three new pharma firms. Toichi Takenaka, chief executive of one of them, Astellas, says it was growing international competition that pushed him to merge and redeploy his R&D and sales force. Linking up with a foreign firm through acquisition or alliance can have a similar effect. The part-acquisition by Roche of Chugai, one of Japan's most innovative drug companies, has boosted the company's R&D activity and allowed some western techniques to be introduced. For example, Chugai is now starting to create specialist sales forces to sell its cancer drugs, and is even reaching out to patients.

Mergers and alliances also help Japanese firms expand abroad. Roughly 10% of the world's top 50 drugs already come from Japan, but they tend to be co-developed and sold by western firms. Takeda, Japan's largest drug firm, already derives over 40% of its revenues from outside its home country. Astellas now has enough money to conduct clinical trials abroad, which are critical for early entry to western markets. Japanese firms are still a long way from giving western giants a run for their money; but remember that people also laughed at the thought of Japanese cars on American streets.

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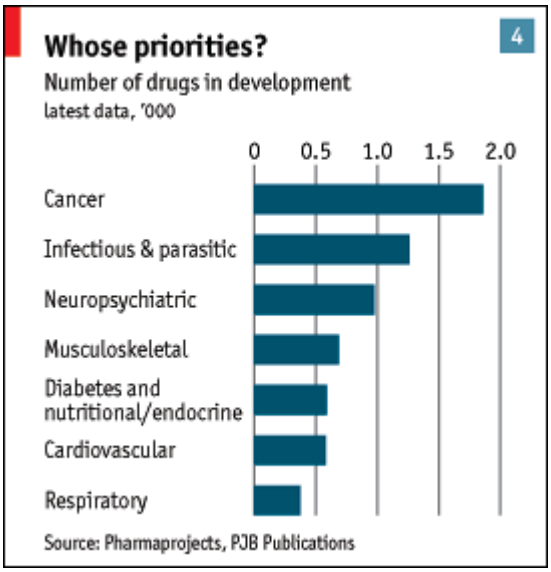
Alternative medicine

Jun 16th 2005
From The Economist print edition

Neglected diseases are fighting for attention



ASK a big drug-company boss why he is in the business of making pharmaceuticals, and he will say he wants to “address unmet medical needs”. But not all medical needs are equally attractive. Most of the 7,500-plus medicines currently in development by biotech and pharmaceutical companies are for chronic diseases of the rich world. At the same time, some of humanity's nastiest afflictions get little attention. Tropical diseases, such as sleeping sickness or leishmaniasis, are a turn-off for drugmakers because they strike mainly in poor countries and offer little hope of an attractive return on investment. Of the 1,500 or so drugs launched over the past 30 years, fewer than 20 deal specifically with tropical disease.

However, it is not just poor countries that are missing out. For example, there is an urgent need for new antibiotics in industrialised countries as drug-resistant bacteria emerge. Yet antibiotic development—once the cornerstone of the drug industry—has fallen out of favour with Big Pharma firms because of scientific hurdles and regulatory requirements.

One way of getting attention for neglected diseases is for patients to take action. For example, the ALS Therapy Development Foundation, started by James Heywood, whose brother was struck down by this neurodegenerative disease, is using its modest budget to test hundreds of compounds in mice and men in the hope of finding a treatment for ALS.

Another route is to launch public-private partnerships. Drug companies contribute molecules, manpower and machines to not-for-profit groups that co-ordinate product development, funded mainly by private sources such as the Gates Foundation, with some government money. There are now about 20 such partnerships, focused on developing new drugs, vaccines or diagnostics for particular diseases of the developing world that will make them accessible to poor populations.

A few big drugmakers, such as GSK and Novartis, which inherited an interest in tropical disease from their parent firms, have chosen to invest in at least early-stage R&D in malaria, tuberculosis and dengue, with a view to partnering later on. They are motivated mainly by philanthropy, but also want to polish their image and hope to sell to travellers and to a rising middle class in developing countries.

Many of the partnerships act as virtual pharmaceutical companies, bringing together expertise from far afield. The Drugs for Neglected Diseases initiative, for example, has drawn together basic research from

academics in Venezuela, molecules from Japanese and French drugmakers, clinical trials in Ethiopia and manufacturing by Brazilian firms.

The question is how to get the products out of the pipeline and to the people who need them. Development costs can be lower than in Big Pharma, in part because clinical trials for diseases such as malaria can be smaller, faster and therefore cheaper to run than for, say, Alzheimer's disease. Even so, Christopher Hentschel, head of the Medicines for Malaria Venture, reckons it will cost at least $100m to bring just one of its products to market, so much more money is needed.

All together now

One idea under discussion is “advance purchase commitments”—meaning that governments promise to buy products that meet certain standards at a pre-arranged price, thereby providing big drug firms with the promise of a certain return. But critics say that governments may well end up overpaying for the goods.

Another possibility is paying pharmaceutical firms in kind. For instance, they could be given longer intellectual-property protection, or faster regulatory approval, on a product of their choice, in exchange for developing one for a neglected disease. But generic drugmakers and consumer groups say this will dent competition and prop up prices.

A more radical proposal is for governments to sign on to an international treaty to devote a certain proportion of their GDP to R&D for drugs and vaccines, particularly for neglected diseases. Part of the plan is to create a prize system, paying a lump sum for an innovation which will then be placed in the public domain. But governments are notoriously bad at valuing innovation properly, and implementing this plan might be tricky.

Yet another tack is the Tropical Disease Initiative, which is trying to harness “open source”, an idea pioneered in computer software. The aim is to bring together scientists through the web to trawl through databases and do computer experiments to find promising new molecules to feed into the public-private partnerships—all patent-free.

None of these strategies is perfect, admits Stephen Maurer, a backer of the initiative at the University of California at Berkeley. The important thing, he says, is to move beyond “dreamy first-world arguments” about which approach is more ideologically sound, and start looking at the real costs of what might be done.

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Devil in the detail

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From The Economist print edition

The art of pushing pills

The blockbusters 5
Top ten brands, global sales, 2004, $bn

Lipitor (cholesterol-lowering)	12.0
Zocor (cholesterol-lowering)	5.9
Plavix (anti-clotting)	5.0
Nexium (anti-ulcerant)	4.8
Zyprexa (anti-psychotic)	4.8
Norvasc (anti-hypertensive)	4.8
Seretide/Advair (anti-asthma)	4.7
Erypo (blood-cell booster)	4.0
Prevacid (anti-ulcerant)	3.8
Effexor (anti-depressant)	3.7

Source: IMS Health

A PRETTY blonde sales rep sits opposite a doctor, ready to promote her company's best-selling drug. “So does Zestran work?” the doctor asks. “About as well as the others,” she shrugs. “We're more expensive; actually we're almost double the cost.” As for Zestran's side-effects, “Patients won't shit for a week.” The flabbergasted physician wonders why he should let this drug anywhere near his patients. “Because I'm going to be perfectly straight with you,” the rep replies. “You're going to know exactly what your patients are getting with this drug, the good, the bad, the ugly—not some sugar-coated version.”

If this scene sounds improbable, that is because it comes from a film. “Side Effects” is the story of a perky young political-science graduate who joins a drug company to promote medicines to physicians, but finds the hard sell too much. Before quitting her job, she decides to give doctors a dose of reality by telling them the complete truth about the products. Remarkably, her sales rocket, her bonuses swell and she finds it ever harder to leave.

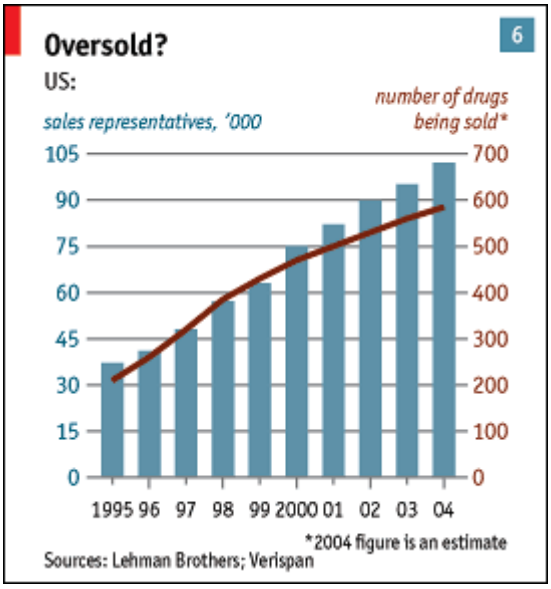
The film's writer-director, Kathleen Slattery-Moschkau, was a sales rep in the American mid-west until 2002. Much of “Side Effects” is fictional, she says, but many of its observations are true to life. When she was selling drugs, Ms Slattery-Moschkau's greatest fear was getting out of her depth when physicians started asking questions. Reps—who are invariably good-looking—were told never to let a doctor discuss the price of a drug. “It was not about getting a doctor to write a prescription for the best drug,” Ms Slattery-Moschkau recalls, “but your drug”.

Many of the promotional techniques used by drug companies are similar to those for selling cars. But drug reps do not actually sell drugs; they explain, or “detail” their products to physicians, and hope to persuade them to prescribe the drugs. Pharma firms back up this effort with ads and articles in medical journals, sponsored conferences and continuing medical education, plus direct-to-consumer advertising in some countries. The past decade has seen a massive rise in pharmaceutical marketing, to the point where a firm such as Novartis is spending around 33% of sales on promotion, compared with about 19% on R&D.

There has been a public outcry, especially in America, over the cosy relationship between doctors and drug companies. Some practices are illegal, others are simply part of the customary trio of food, flattery and friendship. But the days of wining, dining and free trips are slowly fading, at least in rich countries.

There has been a similar outcry about the industry's secrecy over clinical trials. Last year, GSK settled a lawsuit brought by Eliot Spitzer, New York's state attorney-general, which alleged that the firm had suppressed data showing a link between use of one of its antidepressants and suicidal tendencies in young people. Since then, a number of companies have volunteered to register their trials and report their results after a medicine is approved. But companies are still wrangling over how much information they are prepared to share, for fear that they might be giving away a competitive advantage.

As for “detailing”, drug-company bosses defend it as a means of technology transfer. A greater emphasis on blockbuster drugs, together with several mega-mergers over the past decade, has caused the number of reps in rich countries—and particularly America—to rocket, along with the numbers of drugs they are selling (see chart 6). Doctors known to be heavy prescribers are bombarded by up to half a dozen salesmen from the same company selling the same product because the drug companies know that more reps mean more sales. The average rep detailing to primary-care doctors generates $1.9m in sales each year, according to an analysis by Lehman Brothers. An additional 1,000 reps—at a cost of $150,000 a head—can bring in an extra $1.9 billion.



Drug companies have a powerful incentive to drive sales as hard as they can. Their patents are filed early in development and are being squeezed at both ends. Precious time is eaten up in clinical trials before the drugs come to market, and afterwards generic companies pile in. Meanwhile, other big drugmakers snap at their heels with rival products.

Even so, some firms are now starting to question their sales strategy. “Society doesn't want us to spend more money on marketing, and I agree,” says Jean-Pierre Garnier, head of GSK. But drug firms are caught in a classic dilemma: the first one to reduce its sales force will lose market share unless its rivals do likewise, and they are not allowed to co-operate: “We'd go to jail, that's anti-competitive behaviour,” notes Tom McKillop, head of AstraZeneca.

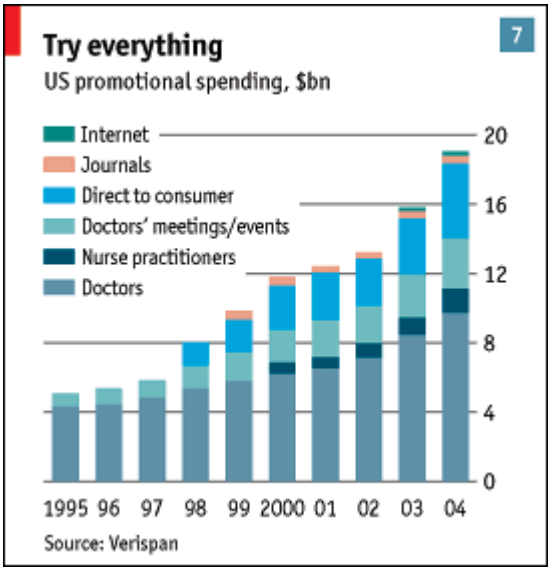
Pfizer, the world's biggest drug firm, is famous for its marketing prowess (it makes Viagra), but in April it announced a $4 billion cost-cutting programme, some of which will fall on its 38,000-strong international sales and marketing machine. In America, the firm is cutting the number of reps detailing a product to the same doctor.

Sales depend not just on how many reps you have but what you do with them, so Pfizer is also reorganising its reps the better to match Medicare's new prescription-drug coverage for the elderly. In America, drug firms already have access to a great deal of information about how each doctor behaves. New technology helps: Pfizer has tested issuing reps with tablet PCs so they can answer doctors' questions in greater depth.

Bristol-Myers Squibb has moved to using contract salespeople, who are easier to hire and fire as the pipeline fills and empties. The firm is also considering the use of tiered sales forces—better-qualified and better-paid reps to do the hard detailing, less high-powered and less expensive staff to deliver samples.

Perfect pitch

Another sore point for the industry is direct-to-consumer advertising. Only America and New Zealand allow makers of prescription drugs to promote their wares directly to the public. In most other countries the practice is prohibited. The proponents of consumer advertising argue that it helps make patients aware of medical conditions they may not have known about and gives them more information for discussing their condition with their doctor. Critics counter that such promotion encourages consumers to badger their doctors, compromising the quality of care and the doctor-patient relationship.



Drug companies have trebled their spending on direct-to-consumer advertising since it was legalised in America in 1997 (see chart 7), and the investment seems to have paid off. A study by IMS Health, looking at 49 brands advertised between 1998 and 2003, shows that the average return on $1 spent on advertising a blockbuster drug was more than $3.50.

But Vioxx may change that. The money that Merck and Pfizer poured into promoting COX-2 inhibitors undoubtedly drove many patients who might have done just as well on older drugs to ask their doctors for the latest thing. The perverse effect of this mass marketing is that drugs which would have been truly beneficial for a small proportion of patients are now out of reach for everyone.

Many drug-company CEOs admit they need to think again about direct-to-consumer advertising. AstraZeneca's Mr McKillop says he was never a great fan, but last year AstraZeneca spent $240m promoting Nexium, a controversial successor to its best-selling anti-ulcer drug which went off-patent, according to Verispan, a market-research firm.

A ban on such advertising in America is unlikely, given the country's constitutional protection of commercial free speech, but companies are beginning to accept that they need to change the way they advertise drugs to the public. Johnson & Johnson, for example, is now running ads that offer a more balanced presentation of risks and benefits. Pfizer is launching disease-awareness commercials, with its logo tucked in a corner. And Eli Lilly consults with payers and physicians before consumer campaigns.

But at a time when consumers are increasingly encouraged to take control of their own health, and expected to foot more of their own drugs bill, pharma firms need to do better than flood the airwaves. Other complicated businesses, such as retail banking, arguably do a better job of putting their message over to the public. To be fair, drugmakers are trying to reach out to consumers in other ways, through websites, e-mail and call-centres. Roche is looking at sending SMS texts to patients to remind them to take their medicine. But such things are only a beginning. The pharmaceutical industry must do more to show that it is not the cause of today's health-care troubles but part of the cure.

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Counter culture

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Many prescription drugs are moving to over-the-counter

REACHING out to consumers comes naturally to the cheaper and, these days, more cheerful side of the business: over-the-counter (OTC) medicines. For example, Xenical, Roche's anti-obesity drug, was launched with great fanfare in 1998, but sales failed to take off, in part because of the way the drug works: it blocks the absorption of fat in the gut, so greasy foods come out at the other end as oily stools. Earlier this year Roche teamed up with GSK to turn Xenical into a lower-dose over-the-counter medicine. Instead of getting a bottle of pills, customers will buy a weight-loss kit with information and advice on how to change their diet and behaviour. So the drug becomes a tool to help customers identify and avoid hidden fats in food. Provided it meets all the FDA standards for safety, efficacy and customer comprehension, the drug could be on the market next year. Such consumer marketing—where a pill becomes part of a broader health-care solution—is just the sort of thing prescription drugmakers need to do more of.

The OTC market used to consist of drugs to treat acute conditions that were easy to self-diagnose, with little potential for harm from abuse by the patient. The new generation of OTC drugs, switched from prescription status, break that mould. They include Zocor, a cholesterol-lowering statin, which was switched last year in Britain, and Prilosec, an anti-ulcerant now available over the counter in America. Others that might make the leap in the next few years are drugs for asthma, osteoporosis and migraine. OTC drugs are sold much more cheaply than branded prescription pills, but big drug firms welcome them as a way of managing their product lifecycle, especially when a drug is about to go off-patent.

Private payers and governments like OTC because it offers the potential of reducing their drugs bills and saves on the cost of doctors' prescriptions. Such switches also fit well with the movement towards empowering patients. In Britain, taking Zocor OTC is part of a government strategy to help people at moderate risk of a heart attack to control their cholesterol levels.

America's FDA is also keen on selling more drugs over the counter. But America lacks the sort of “behind-the-counter” system found in many European pharmacies, where pharmacists hand out advice together with the medicine. Until something similar is introduced there, many potential OTCs will have to wait.

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The cost of living

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Drug prices need fresh thought

IN CHELMSFORD, Massachusetts, Tom and Linda Fall go through their ledger of medical expenses. The middle-aged couple have spectacularly unlucky medical histories, including diabetes, heart attacks, bypass surgery and a heart transplant. Between them, they take more than 30 drugs at a monthly cost of over $700, a quarter of their income. They have had trouble getting and keeping private health insurance, and have sold their house to help pay their medical bills. To their relief (mixed with embarrassment), they have just qualified for Medicaid, a state-funded insurance programme for the poor. Next year, Mr and Mrs Fall will get help from the federal government's new Medicare Prescription Drug Benefit for America's elderly, but still worry about the remaining cost. Mr Fall, although full of praise for the drugs, wonders why the prices have to be so high.

The price of pills is arguably the biggest bone of contention between drug companies and the outside world. Drug companies say that theirs is an increasingly costly and risky business; without prices that allow an adequate return on investment, pharmacological innovation will grind to a halt. This has fostered the belief that there is a connection between the price charged for a particular drug and the cost of the R&D that was needed to produce it. Not so. “The conventional fallacy is that the cost of R&D drives prices,” says Frederic Scherer, an economist at Harvard University. “In reality, it's the other way round: prices drive costs.” The more a company can charge for a drug, the more it will spend on developing and marketing it.

Unlike the science that goes into developing a drug, pricing is a bit of a black art that takes account of a number of factors, including how much better the drug performs than other treatments, the price of rival drugs already available, and what the market will bear. In rich countries, where governments generally foot their citizens' medical bills, a wide variety of tools are used to control drug spending. This infuriates drugmakers and does not necessarily make consumers happy either, because lower prices in a market tend to delay the arrival of new drugs.

Drug companies have been able to make up the money in America, where up to now the market has been willing to pay more for the latest products. But as employers shift more of their health costs on to employees, Americans are starting to ask why their drugs are more expensive than elsewhere. “People here are rightly very frustrated and angry that they are paying more for what looks like the same medication as many people get at a lower price in other parts of the world,” says Mark McClellan, head of the Centres for Medicare & Medicaid Services, the agency that administers the programmes.

So is the rest of the rich world free-riding on America? The answer depends on the type of drug and the particular supplier. Different Americans pay vastly different prices for their drugs. Some of the least well-off consumers, like the Falls, pay some of the highest prices because they do not come under the umbrella of a big employer or government agency that can negotiate discounts.

On the whole, generic drugs are actually cheaper in America than in many parts of Europe, according to Panos Kanavos, an economist at the London School of Economics. (A floor price, along with higher distribution costs, make generics in Europe relatively pricey.) The price differentials that really agitate

Americans are those on blockbuster patented medicines, for which they pay much more. But a recent survey conducted by Mr Kanavos of the top 50 branded drugs in ten industrial countries shows that the differentials between prices in America and other rich countries are narrowing. The ten oldest drugs, launched before 1988, are up to four times more expensive in America than elsewhere; the ten newest drugs, launched after 1997, are only twice the price.

Narrowing the gap

America is keen to narrow the gap further. John Baldacci, governor of the state of Maine, is leading an attempt to persuade the federal government to allow cheaper prescription drugs to be brought in from Canada. Several bills are before Congress to permit so-called “reimportation” of pharmaceuticals from abroad; at the moment, the practice is technically illegal, but the authorities turn a blind eye to individuals bringing medicines for personal use across the border. Many American officials, and drugmakers, object to reimportation on the ground of safety, saying it exposes America to counterfeit drugs. Canadian politicians, for their part, are worried that pharmaceutical companies will stop supplying their country and drug supplies will run low.

Reimportation is just one of a range of tactics that the Americans are trying in order to control their drug bill. These aim at two targets: reducing the volume of new patented drugs consumed, and ratcheting down the prices paid for them. These measures are beginning to work: growth in retail drug sales last year slowed to 8%, the lowest in a decade.

Many of America's drugmakers take heart from the impending Medicare Prescription Drug Benefit, which will provide an estimated 29m elderly and poor people with at least partial coverage for their drug costs, and could boost the industry's sales by 2%, according to some estimates. The programme will be administered by private health-plan providers which will negotiate discounts with drugmakers. Dr McClellan reckons that competition for participants, combined with more price transparency thanks to the internet, will cause providers to drive hard bargains. Others are not so sure. “Medicare could have sent a strong signal to drugmakers. But because the law says there shall be no government negotiation over prices or formularies, we put a large lead shield over the beacon,” says Jerry Avorn, a professor of medicine at Harvard.

Spending more on drugs is not necessarily a bad thing. There is plenty of evidence to show that greater use of certain blood-pressure medications, for example, yields large overall savings through fewer hospitalisations and higher productivity when the patient is at work. What payers in America want to know when they decide whether to cover a drug is how its performance for a given condition compares with that of other drugs, says William Fleming, head of pharmacy at Humana, a big American managed-care company.

America's standards for regulatory approval require only that the drug in question be tested against a placebo to demonstrate safety and efficacy. In Europe, governments often ask drugmakers to test their drug against another of the same class to compare effectiveness before deciding whether to reimburse them. Britain, Australia and a number of other countries have also created special bodies to evaluate the cost-effectiveness of medicines and advise government on whether it is worth paying for them.

There are growing demands among American health insurers, big employers and state governments for something similar so that they can make better decisions on drug reimbursement. If more payers knew whether the drugs they pay for represent value for money, they might encourage drug firms to concentrate on developing the most cost-effective ones.

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The next big thing

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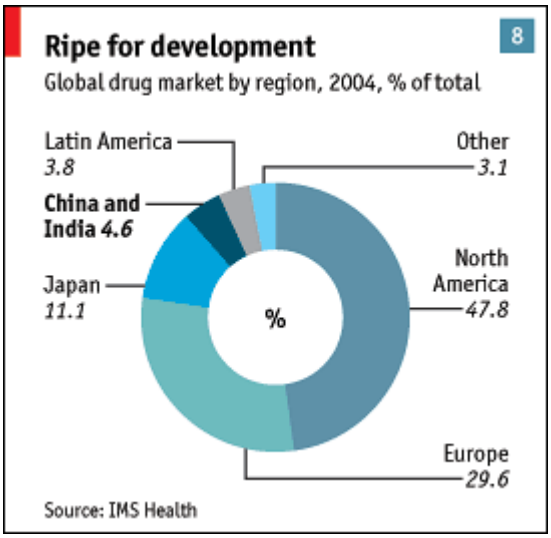
India and China hold great pharmaceutical promise



TO APPRECIATE the promise, and the problems, of globalisation for today's giant drugmakers, take a trip to Mumbai. Drive past the slums of the city and the lush villas of Malabar Hill to the R&D headquarters of Nicholas Piramal, one of India's leading drug companies. With their extensive labs and state-of-the-art equipment, they are a far cry from the western stereotype of India as the land of cheap copycats. Nicholas Piramal's ambition is to bring a new anti-cancer medicine to market for less than $100m.

Western drugmakers have their eye on the rising urban middle classes of India, China, Brazil and other emerging economies, with their increasing incidence of diabetes, cardiovascular disease and other rich-country afflictions. In such countries, most spending on medicine comes out of customers' own pockets, not from some health-insurance scheme. As a result, the drug markets in these places are still small, and dominated by local generics. But the growth rates are astounding: IMS Health predicts that India's market will grow by 10% this year and China's by 19%.

But how to make sure the poor get a look-in too? In the late 1990s, western drugmakers were publicly taken to task over high drug prices in some of the world's poorest places by groups such as Médecins Sans Frontières and Oxfam. Most big drugmakers now have donation schemes for drugs to treat diseases such as leprosy and HIV. Firms are also voluntarily licensing some of their drugs to makers of generics in Africa, and putting up with the fact that generic companies in rich countries such as Canada are making drugs for poor ones that lack a home-grown industry. On the whole, though, big drugmakers tend to think of poor consumers in terms of philanthropy rather than good business. “I think it's wonderful as a concept, but I need practical applications,” says Daniel Vasella, head of Novartis.

Poor people in stronger economies such as China and India are a trickier proposition, with drugmakers worrying that cheap or free drugs might cannibalise sales among the better-off. The biggest attraction of emerging economies, however, is not as markets to sell more drugs but as places for doing R&D and manufacturing. The post-war order in which pharmaceuticals were developed solely in Europe and America is changing. Singapore, for example, is investing billions to turn itself into a global centre of biomedical research and pharmaceutical development; South Korea is a rising star in biotechnology; and Brazil is trying to position itself as a leading supplier of generics to the developing world. Western drugmakers welcome the prospect of low-cost, high-yield partnerships with these newcomers, but worry about the competition they may generate. As in other fields, the most important contenders are India and China.

Crouching tiger

India is one of the few countries where people sound enthusiastic about the future of the drug industry. The excitement has been over 30 years in the making. In 1970, India introduced “process” patents which, unlike patents in America, allowed innovators to protect the way they made drugs, rather than the molecules themselves. This spawned thousands of small drug companies that copied drugs by inventing new processes—a perfect breeding ground for creative chemists.

About a dozen of these firms have turned into profitable businesses, publicly listed but essentially owned and run by the founder and his family. Indian companies' biggest competitive advantage is that they are cheap: they can develop, test, manufacture and market a generic medicine in India for 20-40% of what it costs in the West. But they are also able to develop better versions of old mouse traps, such as combination pills. This mixture of low costs and ingenuity has helped Indian firms expand their sales and acquire companies far beyond their borders. Both Ranbaxy and Dr Reddy's, India's two largest drug firms, have daring patent strategies, challenging big drugmakers on some of their core patents in key western markets.

Such bets can pay off handsomely in America, where the first generic company to succeed in challenging a patent wins a six-month head start in the market. But they can prove expensive: Satish Reddy, managing director of Dr Reddy's, reckons his firm spent $12m on legal bills last year, an amount equivalent to a quarter of its R&D budget. The mother of all patent battles is Ranbaxy's challenge to Pfizer's patent on Lipitor, a cholesterol-lowering treatment that is the world's best-selling drug. If Ranbaxy wins in America, the consequences will be enormous not just for the Indian firm, but for Pfizer too.

Other Indian firms, such as Wockhardt and Biocon, are making “biosimilars”—copies of such biotech drugs as insulin and human growth hormone. An estimated $13 billion-worth of biological drugs are due to lose patent protection by 2008. But biosimilars are more difficult to make, test and market than conventional generic medicines.

Earlier this year, India took another step into intellectual-property protection by recognising full product patents on pharmaceuticals, thereby fulfilling its commitment as a member of the World Trade Organisation. The law caused an outcry by public-health activists, who worry about its effect on drug affordability not just in India, but in even poorer countries that rely on Indian drugmakers for their medicine.

Multinational drugmakers have been slower than financial-services firms or carmakers to take advantage of offshoring. With the new patent law, foreign drug firms can now feel a little more comfortable about shifting more of their operations to India, which is churning out over 120,000 chemists and chemical engineers a year. Indian chemists are well trained and cheap to employ, at an average of $60,000 a year, all costs included, compared with $250,000 in America. Many foreign drugmakers are also turning to India for manufacturing their active pharmaceutical ingredients.

Clinical trials are another point of contact between east and west. At the moment, only a quarter of clinical trials for western drugmakers take place outside America, according to A.T. Kearney, a consultancy. India has a large pool of doctors, many of whom are western-educated and speak good English, and a plentiful supply of so-called “treatment-naive” patients who are not in the habit of consuming pharmaceuticals, making clinical trials faster and cheaper.

But some companies have discovered snags. The number of hospitals with the infrastructure to undertake clinical trials is still limited, and patients need to be followed closely so they do not drift away. Some Indian firms—among them Ranbaxy and Cipla—have had problems with Indian contract research organisations in the past that caused some of their drugs temporarily to be taken off the World Health Organisation's approved list. But with experience, quality is improving.

Given India's success in software—a model for many Indian drugmakers—it is no surprise that foreign pharma firms are turning to the country for IT skills. Novartis has set up an informatics centre in Mumbai. Wyeth has contracted its clinical-trials data management to Accenture, with operations in Bangalore. Vast rooms with hundreds of cubicles are filled with young Indians who transfer data from doctors' clinical-trial reports into databases, check for discrepancies and errors, and provide feedback to doctors within days.

Some Indian drug companies saw the new patent change coming years ago and realised that future growth would come from innovation, not imitation. Today, the country's top ten drug firms collectively spend $170m on R&D. But most of the new molecules they are looking at are directed against disease targets already tried and tested in the West.

The emergence of a research-based industry is also a strong recruiting tool for India Inc. In the past, many of the country's chemists ended up abroad because there were few opportunities at home; an estimated 15% of scientists working in the American drug industry are of Indian origin. Now a burgeoning Indian drug sector, combined with tougher times in America, is luring many of them back.

Indian firms may be competing with western drugmakers on generics, but they are keen to collaborate with them on new molecules. Ranbaxy, for example, has a deal with GSK to share discovery work. Biocon has taken a different tack, pairing with the Cuban Centre for Molecular Immunology to help it develop antibody treatments and cancer vaccines. And Glenmark Pharmaceuticals signed a $190m deal, the biggest in India, with Forest Laboratories in America to develop its new anti-asthma drug. But Indian firms are finding there is no leapfrogging the West's painful experience that drug-making ends in failure more often than in success.

Some firms are trying to load the dice by turning to traditional medicine. Lupin has joined with the Indian government to develop a drug for psoriasis based on a traditional plant remedy. R.A. Mashelkar, director of the Council of Scientific and Industrial Research, believes the drug, which is about to enter mid-stage clinical trials, could reduce the cost of treatment to a small fraction of the $20,000 that western medicines cost.

But whether India's pharma firms will continue to take an interest in poor patients' needs remains to be seen. A recent survey of Indian firms by Jean Lanjouw of the University of California at Berkeley shows that at most 10% of R&D spending by Indian drug firms is on products specifically suited to developing countries. As Kiran Mazumdar-Shaw, head of Biocon, puts it: “In India, we are in a quandary about being mercenary and missionary.”

For all its promise, India still poses problems for domestic and foreign drugmakers alike. Some early drug testing remains tricky, and there is far too much red tape. A patent law on paper does not necessarily mean intellectual-property protection in practice. And Indian firms and investors will have to get over their revenues-at-any-price mentality and take a longer-term view of drugmaking, says Viren Mehta of Mehta Partners, an investment firm.

Bidden dragon

China has leapt ahead of India in many industries, but in pharmaceuticals it lags behind. Like India, it has a massive pool of well-trained chemists and a low cost base; but whereas India has produced a number of sizeable market-oriented drug companies, the Chinese industry has been dominated by sluggish, state-owned enterprises that are not internationally competitive. The sector is now in upheaval as the government is selling off assets and introducing minimum manufacturing standards. But as yet China lacks firms like Ranbaxy that can take on western markets.

Many foreign drugmakers now expect China to catch up with India quite quickly, but it will be some time before “Made in China” will be found in every western medicine cabinet. In the meantime, China already offers foreign firms opportunities for outsourcing because it is a world leader in basic pharmaceutical manufacturing. Even Indian firms have set up shop in China to produce raw materials more cheaply than at home. With an ample supply of suitable doctors and patients, China is also emerging as a centre for clinical trials. AstraZeneca works with some 20 hospitals on clinical trials for cardiovascular and respiratory drugs—not just to get their drugs on to the Chinese market, but as part of their global testing programme.

Traditional Chinese medicine, which accounts for 30% of the Chinese drug market, offers another opportunity. Bigger drugmakers are taking another look at traditional medicine as a way of finding new

molecules to test against their disease targets. Novartis, for example, hopes its alliance with the Shanghai Institute of Materia Medica will deliver 1,500 new molecules from botanical and microbial sources in the next three years. One of the company's most important medicines—Coartem, a malaria treatment—has its origins in traditional Chinese medicine.

Although China lacks India's array of corporate partners, a few foreign firms are now taking the plunge and trying to do some of their early research in China. Eli Lilly has partnered with Shanghai ChemExplorer, a contract chemistry group. Roche has set up its own chemistry centre in Shanghai, and Novo Nordisk, which produces biotech products, has established a research centre in Beijing. But as John Wong, of Boston Consulting Group, points out, investing in research in China at this stage is as much of a commercial as a scientific decision. The Chinese government is keen on foreign pharmaceutical investment as a route to technology transfer. Drugmakers' investment in R&D may well pay off when they negotiate to get their drugs on to official reimbursement lists.

Like India, China has its drawbacks. The government regulator is slow in approving applications for clinical trials and marketing. And although the country strengthened pharmaceutical patents in 2001, companies still worry about enforcement. China has a thriving counterfeit-medicine industry—a big headache for western drugmakers and public health authorities around the world. Last year, the Chinese government overturned Pfizer's patent on Viagra, sending chills down the spines of western drugmakers.

China still lacks the tight links between academia, government research and industry that have been such a boon to America's drug industry, and there are cultural differences too that can get in the way. Generally speaking, Chinese scientists are more reluctant than western ones to question authority. “There are a lot of pearls here on the table,” says Andreas Tschirky, managing director of the Roche centre. “Now we need to link them in a chain.”

Jonathan Wang of Burrill and Company reckons that although China lags behind in conventional drugmaking, it may well leap in front in biotechnology. Whereas western researchers are going slow on gene therapy because of safety concerns, China already has a product on the market for head and neck cancer, and is pushing ahead with stem-cell research too.

Emerging firms in countries like India and China are more of an opportunity than a threat for established drugmakers. “The most efficient way of making a computer is in cross-border transactions, making the design in one place, the chip in another, the keyboard somewhere else and then assembling the whole thing. The same will happen in drugs as well,” says Swati Piramal, of Nicholas Piramal. With the right support from western industry, that could be good for drugmakers—and their customers—everywhere.

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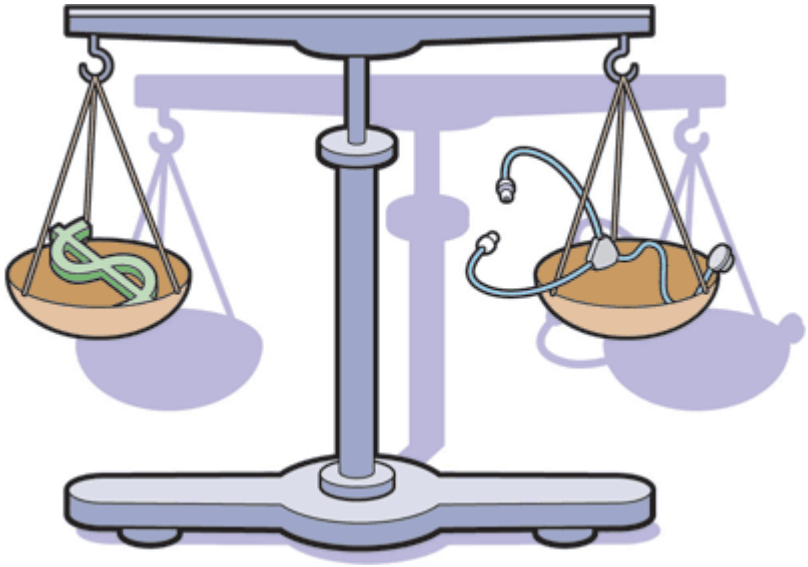
Heal thyself

Jun 16th 2005
From The Economist print edition



What the industry should do to get better

FOUR years ago, Novo Nordisk, a Danish drugmaker, was embroiled in a court case in South Africa. Together with 40 other drug companies, it was suing the South African government over its patent laws. For the pharmaceutical industry, this became a public-relations nightmare. Drugmakers stressed the importance of intellectual-property rights to encourage innovation, but non-governmental organisations argued that patents and high prices were condemning millions of poor AIDS patients to death.

Novo Nordisk does not actually make anti-retroviral medicines—the drugs at the heart of the South African debacle—but it is one of the world's leading producers of insulin and other diabetes drugs. Its boss, Lars Rebien Sorensen, realised that the problems the AIDS drugmakers had encountered could well be repeated over medicines for diabetes, a widespread disease in the developing world as well as in rich countries. So Novo Nordisk set up the World Diabetes Foundation, pledging $100m over ten years. The foundation works in 40 developing countries to raise awareness of diabetes and improve care in places where it is seriously underdiagnosed, such as India and China. There is no pressure on the foundation's beneficiaries to buy Novo's products; in fact, says Mr Sorensen, he prefers them to get their drugs from domestic generic suppliers. Where they do use Novo's products, the firm offers an 80% discount on prices charged in America and Europe.

Novo's local offices also teach doctors and patients how to prevent diabetes through diet and lifestyle, as well as setting up ancillary services such as foot-care clinics for diabetic ulcers. It might seem odd for a drug company to promote practices that could possibly reduce its sales, but Mr Sorensen reckons it is worth it for the long term. “Only by offering and advocating the right solutions for diabetes care will we be seen as a responsible company. If we just say, ‘drugs, drugs, drugs’, they will say, ‘give us a break’.”

Novo's example suggests that drugmakers might actually further their fortunes by teaching people when, and when not, to use their products. People who feel they are getting their money's worth tend to complain less about the bill. Other pharmaceutical companies have been working along similar lines. Pfizer struck a deal with the state of Florida in 2001, helping 150,000 Medicaid patients to monitor and manage such chronic conditions as asthma and diabetes. In exchange, the state waived its demand for additional rebates on Pfizer drugs. The experiment cut Florida's costs by more than $40m over two years. The firm is now testing other health-management programmes in Britain and Italy.

The industry can certainly help improve the way its products are consumed. Sometimes drugs are

overused: one study in Britain showed that two-thirds of prescriptions for so-called SSRI antidepressants, such as Prozac, were for “mild” depression, even though there is no good evidence that the drugs work in these cases. At the other extreme, many drugs, for example those for heart failure, are seriously underprescribed. And patients often fail to take their pills the way they are meant to.

Better use of pharmaceuticals depends on two main factors: a clearer understanding of why and how drugs should be used; and getting people to act on it. Technology can help: e-prescribing, for example, uses computer systems that steer doctors to the most appropriate drug for their patients. Another is setting up the right incentives, such as performance-based payments that reward doctors for achieving certain clinical outcomes in their patients and lower overall medical spending.

Where things have gone wrong, rebuilding reputations takes years. This is easiest for companies that do not have to pander to investors' demands for quick returns. Novo Nordisk, for example, can afford to invest in its programmes because the majority of its voting shares are controlled by a foundation. Roche has been able to make big bets on diagnostics and partnering with outsiders because the company's founding family still controls the voting shares. “The firm long-term commitment of this family which has seen up-and-down cycles of industry over 100 years makes it easier not to fall into the trap of short-term fixes,” says Franz Humer, the company's boss.

Signal failure

But most of the world's big drugmakers have to live with the whims of their investors, who over the past few years have been taking an increasingly short-term view of the industry. This is particularly true of hedge funds, which dip in and out of companies at will. The problem, claims Jeremy Levin, head of strategic alliances at Novartis, is that the respective cycles of the pharma industry and of investors are out of sync: stocks are bought and sold in an instant, whereas industry leaders stay in their jobs for five to ten years, and drug development takes even longer.

But some investors are hoping to encourage drugmakers to take an even longer-term view. Britain's Universities Superannuation Scheme, a £20 billion ($36 billion) pension fund, is concerned about executive pay packages that encourage short-term boosting of earnings per share. The group would like such pay to be based on more meaningful measures, such as the number of drugs moving through clinical development, or return on investment.

“It's very rare that an industry can see a train coming and also has the financial wherewithal to fix it,” says David Blumberg, a consultant with Accenture. Pharma companies still have enough money, and latitude, to make serious changes. They should start at the top. As the current generation of leaders retires, executive boards would do well to look beyond the usual suspects. Some of the drugmakers that have weathered the current storm best have bosses who have moved up from the clinic or the lab. But it is also worth thinking about talent from other industries, such as high technology; just look at the influence that Microsoft's Bill Gates has had on public health worldwide. The trouble is that many drugmakers suffer from a condition best described as “pharmaceutical exceptionalism”—a conviction that their industry is so complex that no one from the outside world can possibly grasp its intricacies.

One company that is looking outward is Wyeth. “We talk to companies in [the] airline, automotive, computer and low-tech [industries], trying to distill in R&D things that other industries do better than us,” says Bob Ruffalo, the company's head of R&D. “I think the last place you will find solutions is in the pharma industry.”

There are plenty of companies outside the industry from whose example drugmakers could learn. BP has managed to sail through rough seas, whereas Monsanto was sunk by genetically modified crops. That example is particularly close to home for the pharmaceutical industry, which saw that Monsanto could not win public approval by simply arguing the merits of its science. “Trust me, I'm a drugmaker,” is no longer enough.

Much of the criticism directed at the big drugmakers is richly deserved, but they do not work in a vacuum. If they are to serve the public better, many other changes are needed in the way health care is paid for and practised. Big pharmaceutical firms are full of clever, creative people who should be able to identify—and act on—big issues without being prodded by outsiders. Big firms, and not just drugmakers, have a tendency to react to events rather than anticipate them, though a few pharmaceutical companies have started trying to look ahead to the next storm.

With both science and social attitudes changing, the days of Big Pharma domination are numbered. Some of today's firms—those that can tap into the best science, streamline their operations and communicate more openly with the wider world—will still do well, although they may be less profitable. But those that cannot reinvent themselves will face decline.

The experience of Big Pharma holds a lesson for biotech firms and other rising stars of health care. Pricing, productivity, patents and safety are as critical to them as they are to the current giants. The next generation of drugmakers needs to deal with these issues more effectively. With the right medicine, the industry's current condition need not be chronic.

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Interesting overviews of biopharmaceuticals:

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Commission on Intellectual Property Rights, Innovation and Public Health

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Inditex

The future of fast fashion

Jun 16th 2005 | LA CORUÑA, SPAIN
From The Economist print edition

Landov

Spain's Inditex, the owner of the Zara chain of fashion stores, has bold but worrying expansion plans

WHEN Spain's Crown Prince Felipe and Letizia Ortiz Rocasolano announced their engagement in 2003, the bride-to-be wore a stylish white trouser suit—which raised some eyebrows among those concerned with royal protocol. But within a few weeks, hundreds of European women were wearing something similar. Welcome to the world of instant fashion, in which a Spanish company is defying conventional wisdom and building a global brand: Zara.

Instead of trying to create demand for new trends in the summer and winter seasons using the catwalks of fashion shows, Zara studies the demands of the customers in its stores and then tries to deliver an appropriate design at lightning speed. In the process, Zara has become the most profitable arm of Inditex, a holding company of eight retail brands, and one of the biggest success stories in Spanish business.

From its beginnings in 1963 when Amancio Ortega Gaona, its founder, began to trade garments, Inditex has emerged as one of the world's fastest-expanding makers of affordable fashion clothing. Since 2000 it has more than doubled its number of shops to 2,240 by the end of last year, with sales of more than €5 billion ($7 billion). On June 13th, Inditex announced net profits up by 21% for the first quarter.

How can Inditex thrive when Europe's entire textile industry is supposed to be under threat from cheap imports from China? At Inditex's heart is a vertical integration of design, just-in-time production, delivery and sales. Some 300 designers work at the firm's head office in La Coruña in Galicia, a poor region in northern Spain. They are in daily contact with store managers to discover bestselling items.

Fabric is cut in-house and then sent to a cluster of several hundred local co-operatives for sewing. When the finished product returns, it is ironed, carefully checked and wrapped in plastic for transport on conveyor belts to a group of giant warehouses. Twice a week lorries deliver the garments to other European countries and by aircraft to the rest of the world.

Production is deliberately carried out in small batches to avoid oversupply. While there is some replenishment of stock, most lines are replaced quickly with yet more new designs rather than with more

of the same. This helps to create a scarcity value. Shoppers cannot be sure that something that has caught their eye will appear in the store again—or can be found at another Zara store, even in the same city. On the other hand, they also know that everyone they meet will not be wearing it.

The result is that Zara's production cycles are much faster than those of its nearest rival, Sweden's Hennes & Mauritz (H&M). An entirely new Zara garment takes about five weeks from design to delivery; a new version of an existing model can be in the shops within two weeks. In a typical year, Zara launches some 11,000 new items, compared with the 2,000-4,000 from companies like H&M or America's giant casual-fashion chain, Gap.

All of Zara's shops use point-of-sale terminals to report directly to La Coruña. On top of that, every evening store managers consult a personal digital assistant to check what new designs are available and to place their orders according to what they think will sell best to their customers. In this way, its store managers help shape designs. Zara does not employ star designers but often unknowns, many of whom are recruited directly from top design schools. Inditex is extremely clever in how it uses technology, says Andrew McAfee, a Harvard Business School specialist in the corporate use of information technology. The company keeps its technology simple—even a little old-fashioned—but as a result spends five to ten times less on information technology than its rivals.

Zara is also more parsimonious with advertising and discounts. It spends just 0.3% of sales on ads, compared with the 3-4% typically spent by rivals. “We try to avoid markdowns”—now an almost permanent feature of American department stores—says José María Castellano Ríos, Inditex's deputy chairman. On June 13th the board appointed Pablo Isla to succeed him as chief executive. Mr Isla, a former co-chairman of Altadis, a Franco-Spanish tobacco company, is not a fashion man. His appointment followed a long search by head-hunters for someone able to manage a company that will inevitably become more complex as it grows and its supply chain lengthens.

Mr Castellano says that over the next four years, Inditex plans to double in size to some 4,000 shops with sales of more than €10 billion. Most of this expansion will be in Europe, where he sees room for growth, especially in fashion-conscious Italy. Some investors are worried about this rapid pace. Over recent months the shares of H&M, a company with more modest plans for expansion, have performed better than those of Inditex.

So far, Inditex has only 16 shops in America, the world's biggest market, and aims to gets its European expansion going before pushing hard on the other side of the Atlantic. By February, H&M had 76 stores in America, so it could get well ahead of its Spanish rival in that market. But H&M does things differently, including the hiring of star designers. Stella McCartney has been appointed to design its autumn collection, which will be sold in some of its European and American stores.

Inditex's caution could be wise. Only two years ago it missed some of the year's main fashion trends. In their assessment of what went wrong in 2003, analysts at CSFB, an investment bank, identified issues of complexity and control as being among the causes—worrying for a company that likes to keep things simple. Even so, José Luis Nueno of IESE, a business school in Barcelona, believes the firm will grow successfully. Consumers have become more demanding and more arbitrary, so fast fashion is better suited to these changes, he argues. Inditex has proven that cheap and fast fashion can also be trendy

and well presented. Zara's stores have won awards for their decoration and their shop windows.

To smooth its growth, Inditex has opened a new distribution centre in Zaragoza. It has also begun to obtain some of its basic garments from low-cost countries, although the bulk of its production remains in Europe. China, for instance, accounts for just 12.5% of its production, less than that of rivals. Yet the further Inditex moves away from home, the trickier it will be to cater to instant-fashion whims. When Madonna gave a series of concerts in Spain, teenage girls were able to sport at her last performance the outfit she wore for her first concert, thanks to Zara. Although Mr Castellano insists that Inditex can be as nimble in other countries as it is at home, that could prove difficult. And if it stumbles, as Mr Castellano must know, the fickle world of fashion will be merciless.

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Dealmaking in Italy

Media intrigue

Jun 16th 2005 | ROME
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Stefano Ricucci, a mysterious corporate raider, makes a splash in Italy

SUCH turbulence has not disturbed Italian finance for many years. Speculative raids on powerful institutions at the heart of the country's business system have set pulses racing in Milan and Rome. On June 9th, more than 5% of the shares of Mediobanca, an influential investment bank, changed hands. Attention switched on June 10th to Generali, a large insurer in which Mediobanca holds 13.6% and which, in turn, holds nearly 2% of the investment bank.

Among big Italian names in Mediobanca's portfolio of shares and alliances is RCS MediaGroup, a publishing concern that owns *Corriere della Sera*, founded in 1876 and now Italy's journal of record and one of its top two dailies.

Until recently, Mediobanca was RCS's largest shareholder with 13.9%. No longer. The arrival of Stefano Ricucci, a 41-year-old former dental technician, has knocked the investment bank off its perch. Filings to Italy's stockmarket regulator show that Magiste International, a Luxembourg-registered company, owns 18.1% of RCS. In turn, according to the filings, the Stefano Ricucci Trust owns Magiste International, and a Guernsey-registered trustee company acts as trustee of the trust. So the ownership structure of Mr Ricucci's empire is not simple. In May, *Corriere's* staff staged a one-day strike, saying that Mr Ricucci's "stake-building, with absolute lack of transparency, generates anxiety".

Mr Ricucci, who had been more prominent in gossip columns than on business pages, now lines up among RCS shareholders with established members of Mediobanca's club, such as Generali, Pirelli and Fiat. He certainly worries those establishment figures. Twice in the past month, the shareholder pact to which they belong and which has 58% of the group's shares, issued statements saying that it was solid and that it would "defend the newspaper's independence against any financial or political speculation".

Because of the concentration of media ownership in Italy—for instance, Silvio Berlusconi, the prime minister, controls the country's largest commercial television company and indirectly the state-owned television company, and his brother owns a national newspaper—a possible change in control of the largest media group that is not owned by Mr Berlusconi is a politically sensitive issue.

How Mr Ricucci fits into this picture is unclear. What is clear, however, is how busy he has been this spring. He has snapped up nearly 5% of Banca Antonveneta and of Banca Nazionale del Lavoro, both currently subject to bids by non-Italian banks. His shares in these banks are worth around €800m ($963m) and his stake in RCS a further €800m.

So where has the money come from to finance these investments? Part of the answer is reportedly bank debt, secured on the stakes. The rest would appear to be the fortune that Mr Ricucci is reported as saying that he has made from property investments in Italy.

If so, companies outside Italy must have made this money. According to company reports filed in Italy, the Italian Magiste companies had assets of €165m at the end of 2003, €133m of which represented amounts owed by Magiste International. And property assets totalled a mere €17m. A recent investigation by *Il Sole-24 Ore*, Italy's leading financial daily, concluded that claims that Mr Ricucci has a property portfolio worth around €2 billion are exaggerated; the paper estimated that €200m was nearer the mark.

Whatever the case, Mr Ricucci and his financiers seem to have placed a big bet on someone bidding for RCS (and the shareholder pact crumbling). If nobody does, he may struggle to get his money back. Speculation is rife that Mr Ricucci will launch a takeover with a secret ally in the shareholder pact, or that

a more powerful investor, perhaps with a political motive, will bid, allowing Mr Ricucci to sell at a profit.

The Economist asked to interview Mr Ricucci but he is “too busy tying up deals at the moment”. So we sent a written request for some basic information about Mr Ricucci himself, his companies and his property portfolio. By the time we went to press we had not received a reply. So this important newcomer in Italian banking and media circles remains an enigma.

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Nokia

The giant's makeover

Jun 16th 2005
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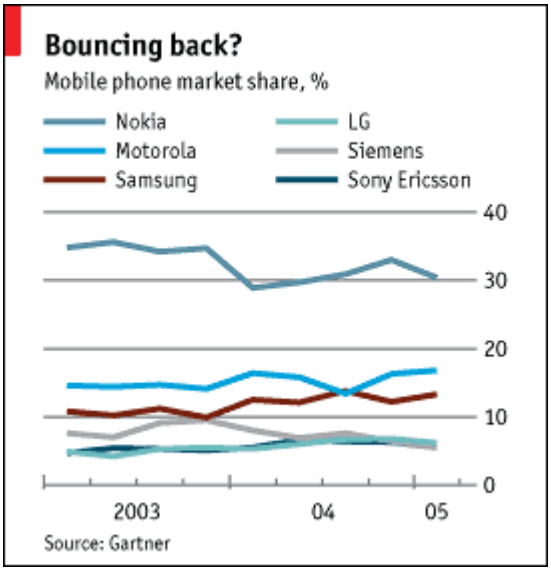
Further evidence of the handset giant's determination to stay on top



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THIS time last year, Nokia, the world's largest maker of mobile phones, suddenly found itself on the ropes. Its market share in the first three months of 2004 had fallen to 28.9%, having hovered around 35% for years. The firm cut prices, but that was only a short-term fix: it then set about addressing the underlying causes. The unveiling of its latest batch of handsets this week provided new evidence that Nokia has changed its ways.

Nokia's woes had two main causes: lacklustre products which failed to address consumers' enthusiasm for “clamshell” or “flip-phone” camera-phones and highlighted Nokia's loss of leadership in design; and the company's reluctance to produce customised versions for mobile operators. Many operators have been turning to specialist “original design manufacturers” (ODMs), mostly based in Taiwan, to supply custom handsets. These are often sold by operators under their own brands, to help differentiate themselves.

So the seven new handsets launched by Nokia this week were telling. Four were “slider” designs, in which the keypad can be hidden under the display, and two were clamshells. “What's encouraging is to see Nokia dumping the ‘not-invented-here' mentality and becoming a fast follower,” says Ben Wood of Gartner, a consultancy. Per Lindberg, an analyst at Dresdner Kleinwort Wasserstein and a noted Nokia critic, says this is the best new batch of handsets the firm has produced for four years.

This follows the unveiling in April of a new line of high-end handsets, the most advanced of which, the N91, includes iPod-style music playback from a tiny hard disk.

Meanwhile, Nokia has also changed its tune on customisation. As well as offering to modify the software on its phones to suit particular operators, it has started to offer custom handsets. The first is being made for China Mobile, with others to follow soon, says Kai Oistamo of Nokia. And having traditionally been reluctant to outsource manufacturing, Nokia has started to use ODMs, as its rivals do, to plug any gaps in its product line. The firm has become “more open-minded, more flexible as the world around us

changed," Mr Oistamo says.

Challenges remain, however. Having bounced back in the last three months of 2004, Nokia had a weaker first quarter this year, largely due to poor sales in North America, where many network operators use CDMA technology rather than the GSM technology used in Europe. "That's their Achilles heel," says Mr Wood. Nokia is said to have done a deal to buy advanced CDMA handsets from SK Teletech, a South Korean manufacturer, for resale under its own brand. This would beef up its range in America, but would also be a tacit admission that Nokia's own CDMA products are not up to scratch. Nokia says no such deal exists, but that may simply mean that no deal has been done yet.

Either way, it is clear that Nokia has changed its ways. "A big dose of humble pie was the best thing that could have happened to the company," says Mr Wood. The company has, he notes, even licensed e-mail and media-playback protocols from Microsoft, its arch-rival in the field of smartphones—something that would have been unthinkable a year ago. Nokia is so determined to stay on top, it would seem, that nothing is sacred.

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Chinese hotels

Somewhere nice to flop

Jun 16th 2005 | HONG KONG
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There is a huge opportunity for budget hotels in China

Star light, star bright
Hotel rooms by number of stars
2002, % of total rooms

	4-5	2-3	1
China	*23*	*72*	*5*
Developed countries	*10*	*40*	*50*

Sources: Guolian Securities; *China Economic Quarterly*

IN THE 1992 film “The Story of Qiu Ju”, Gong Li, China's best-known actress, plays a pregnant peasant who travels to Beijing to obtain justice for her husband. Among her many tribulations is having to stay in a dingy, unsanitary flea-pit of a hotel. The film cannot be faulted for realism. While foreign visitors are cosseted in plush hotels that are the equal of anything in Tokyo or New York, most Chinese travellers—to whom price matters above all else—have little choice but the country's more than 200,000 *zhaodaisuo*, traditional flop-houses with beds at around 80 yuan ($10) in cheerless dormitories with shared toilets and no other facilities.

The China Hotel Association says that, of the country's 300,000 hotels, around 8,800 carry three, four or five stars while most of the rest have none at all. Given China's size, the budget-hotel segment is massively underdeveloped when compared with other countries (see table).

Foreign and domestic chains sense the potential. As the Chinese get richer they are travelling more—increasingly in their own cars—and demanding clean and safe accommodation for a reasonable price. Domestic brands are expanding aggressively. Home Inn, a budget brand part-owned by Ctrip, a Chinese online travel agency, opened its first hotel in 2002 and now has around 50. It will double that number by the end of 2006. Jin Jiang Inn, which also owns Shanghai's famous Peace Hotel, operates some 60 economy hotels and plans to invest 1 billion yuan in a further 200 hotels in five years and more than 1,000 in the longer term.

Some investment groups are now looking for opportunities, and foreign chains are trying to expand. France's Accor launched its first budget hotel, a 154-room, three-star Ibis in Tianjin in northern China in 2003. With a rate of 218 yuan a night, occupancy is over 90% throughout the year. To meet demand, Accor is already adding another 80 rooms, and wants to open another 50 Ibis hotels by 2010.

Mitchell Presnick, the China head of Cendant's Super 8 Motel group, the world's largest chain of franchised budget motels, has opened eight Super 8 hotels since 2004 and expects to open around 300 more by the end of 2008. The group also plans to franchise 40 of its mid-market Days Inn outlets by 2008. Britain's InterContinental Hotels, meanwhile, has negotiated licences for two Holiday Inn Express sites in provincial capitals.

While the Chinese chains build or own their hotels outright, foreigners prefer to franchise, enabling them to expand faster with less capital and at lower risk—though they also have to share profits with franchisees. Franchising only works, of course, if standards are maintained. At Super 8, franchise service managers keep in daily touch with all hotels, use teams of inspectors and offer other support, including a group reservation system.

While Super 8 rooms are small, they come with carpets, wallpaper, free broadband internet access, TV, en-suite bathrooms and a basic breakfast. They do without the fripperies of traditional Chinese hotels. Explains Brian Deeson, chief executive of Accor in China: “The typical Chinese cheap hotel has a bowling alley, several restaurants and a huge reception room to greet the mayor. Our hotels just feed and water people.”

And impressively so. Foreign chains are now achieving occupancy rates of 70-100%, which is far higher than the national average of around 60%. Super 8s have gross operating margins of 45-50%, compared with less than 30% for a five-star hotel. And once they are used to finding a pleasant room at the inn, customers seem touchingly loyal. That should stand the foreign chains in good stead, given that 100m Chinese are expected to travel overseas every year by 2020.

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South Africa's defence industry

Arms and the man

Jun 16th 2005 | JOHANNESBURG
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Can Denel's new boss secure the arms company a future?

SHAUN LIEBENBERG has landed a tough job. After heading Grintek, a South African defence and electronics company, he has taken over the reins at Denel, South Africa's state-owned arms manufacturer. The country's arms industry flourished under apartheid when, because of sanctions, it had to supply the government with all its military needs. But in a changed world does it still make sense to encourage a local champion?

Denel is on the brink of bankruptcy. Last year it increased revenues slightly to 4.4 billion rand ($660m), but its losses ballooned to almost 380m rand. Alec Erwin, the minister for public enterprises, argues that Denel helps the economy at a time when the country faces increasing peacekeeping demands on the continent.

The government wants Denel to stand on its own feet but remain in the public sector. This is part of a larger plan to turn other state-owned enterprises not slated for privatisation into “drivers of growth and development”. The company, involved in all kinds of things—from soybeans and insurance to property—first has to slim down. Mr Erwin thinks there is still about 730m rand of non-core assets that Denel could do without.

Denel has only partially managed to adapt to the end of the cold war and the arrival of democratic government. Government money for military research and development has practically dried up. Today, Denel still provides a big chunk of the South African military's ammunition and maintenance, but almost 60% of the company's revenues come from exports. Yet it still needs to find out what it can sell profitably, and to whom. The company developed some impressive pieces of equipment at great expense, such as its Rooivalk attack helicopters, but has been unable to sell enough of them to recoup its costs.

According to Helmut Heitman, a defence consultant, Denel should focus on specific niche areas where it has world-class capability, develop partnerships and be part of a larger supply chain on big aerospace systems. Denel already works with some aerospace companies, such as Europe's EADS, the maker of Airbus aircraft. In a recent deal, the government has agreed to buy at least eight military transport planes from Airbus, for a total cost of €837m ($1 billion). But Denel will also be part of the production consortium, and the deal should bring 3.2 billion rand worth of orders for South African companies. The purchase, which was awarded without tender, has raised eyebrows in South Africa. Mr Erwin is unfazed. “This is an opportunity we could not afford to miss,” he argues. South Africa needs the planes, while being part of the consortium fits with the strategy of developing the country's aerospace capability. Mr Liebenberg will be hoping for more such deals.

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Shipping

The peaks and troughs

Jun 16th 2005
From The Economist print edition

Bulk-shipping rates have fallen sharply as steel prices slide

THE boom in commodities is mature but far from a slump. Container shipping, which carries many manufactured goods, is healthy. Yet bulk-shipping rates have plunged by more than 55% since early December. Why? The reason is largely steel. Its raw materials, iron ore and coking coal, are the commodities that pushed dry bulk freight rates up sixfold between mid-2002 and their sudden peak in December. Even now, as measured by London's Baltic Exchange, these rates are up threefold since the levels of three years ago.

The cause of the slump lies in China. As world steel prices have begun to slide, those of China's once ever-expansive steel industry have collapsed: hot-rolled coil, a benchmark product, that was fetching $650-700 a tonne two months ago has been on offer there at around $480. So the steelmakers have slowed their raw-material imports.

The shipowners are not yet crying into the champagne glasses they filled in the boom. A Chinese government minister recently predicted that his country's bulk trade would grow from 4 billion tonnes a year to 6 billion by 2010. But new ships are pouring into the market.

Container shipping is much better placed. China's export boom is still doing nicely, and America's big west-coast ports are still inefficient and congested, which means shipping capacity is lying idle. As an official of Yang Ming shipping line recently put it: “We remain on a very high plateau.” But his main message was different; at the other side of the plateau he foresees a drop in his company's earnings, of maybe 15-50% over the next three to five years.

Few analysts would challenge him. China may fight off the hostility to its export drive. Port congestion may remain a problem. But new ships are pouring into the container market as well. China's biggest shipping group, COSCO, with vessels of all types, is about to be floated on the Hong Kong stockmarket. With analysts foreseeing COSCO's still-soaring profits sliding in 2006, the reception of this launch may indicate whether pessimists outnumber optimists.

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Viacom

Old and new media part ways

Jun 16th 2005
From The Economist print edition

To revive its growth in a digital world, Viacom is confounding many of its media rivals by splitting into two

AP

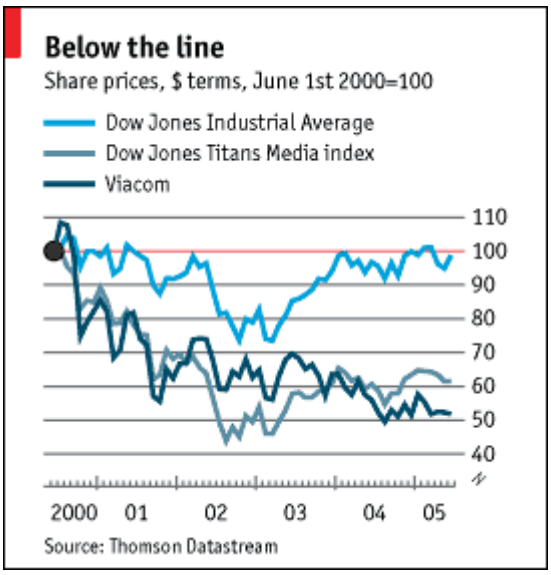
Redstone online

VIACOM, the world's third-largest media company, is extraordinarily good at what it does: feeling the pulse of popular culture and making programmes that get people hooked. Viacom's profits depend on this ability, whether these are earned by CBS, its broadcast-television network; its radio stations; its cable channels such as MTV; or by Paramount, its movie studio. Last year Viacom had sales of $22.5 billion, and its market capitalisation is $51 billion. There is no sign that the firm has lost its creative edge.

Nevertheless, Viacom is about to break itself up and start all over again. This week it formally announced its split into two publicly traded firms. Sumner Redstone, its 82-year-old controlling shareholder, will divide the group into a slow-growing company, to be called CBS Corporation, and a fast-growing one which will keep the Viacom name. The idea is to hive off Viacom's traditional “old” media assets and create a smaller, nimbler version of the company to manoeuvre more easily in a world of “new” digital media, such as the internet, mobile phones and video games. “Sometimes divorce is better than marriage,” reasons Mr Redstone.

“Lunacy”, says an executive with a rival American media firm. “They'll lose a lot of their scale and their market power.” Viacom and the other three big media giants—Time Warner, the Walt Disney Company and News Corporation—have been built on a principle that size matters in media businesses. But times are changing.

The main reason why Mr Redstone has taken such a bold step is that Viacom's overall rate of growth has slowed and its shares have fallen by 23% since the beginning of 2004 (see chart). America's market for advertising on TV and radio is still valuable, but it is mature. Advertising contributed 60% of Viacom's revenues last year, but the market grew at a compound annual rate of just 3% during 1998-2003, according to Veronis Suhler Stevenson, a New York investment bank.



Other parts of the media industry are growing more quickly. Revenue at Viacom's cable networks rose 16.5% last year, though this is likely to slow. Advertising on the internet, video games, satellite radio and selling content to people on their mobile phones are growing the fastest. But Viacom has comparatively little presence in these fields. And even if it did, their relative size would be overshadowed by its traditional media interests.

By making the fast-growing businesses more visible Mr Redstone hopes that the stockmarket will value the two different parts of his empire at more than the whole. The high-growth company's main assets will be the cable networks; Paramount Pictures, a movie studio; and Paramount Home Entertainment. Its boss will be Tom Freston, currently co-chief operating officer of Viacom and who already oversees cable and Paramount. The new Viacom will have a balance sheet designed to allow it to acquire other high-growth assets.

CBS Corporation, on the other hand, will be made up of CBS; UPN (a smaller broadcast-television network); TV stations; radio and outdoor-advertising businesses; Showtime, a cable channel; the CBS, Paramount and King World television-production operations; Paramount's theme parks; and Viacom's publishing firm, Simon & Schuster. Its boss will be Leslie Moonves, currently co-chief operating officer and responsible for CBS, radio and some other operations. CBS Corporation is expected to take on most of Viacom's current debt and will return cash to shareholders through dividends and share buybacks.

Underlying the split is the change in traditional television and radio advertising as consumers spend more time with new media such as the internet. Companies are having to think of new ways to reach consumers. Procter & Gamble and General Motors, America's biggest advertisers, are both shifting more of their marketing budgets this year away from TV in favour of new-media channels and other forms of promotion. At the same time, Americans are becoming accustomed to avoiding advertisements, whether by skipping through them with a personal video recorder, watching video-on-demand or subscribing to advert-free satellite radio.

Sibling rivalry

To some extent, the split simply reverses the $43 billion merger in 1999 that created Viacom. Back then, Mr Redstone merged his group of companies—including MTV and other cable networks, the Paramount movie studio and Blockbuster, a video-rental chain—with CBS, a broadcast-television company which also owned radio and outdoor-advertising businesses.

Yet many media executives outside Viacom reckon it is a mistake to undo that merger. Mr Redstone could boost growth without breaking up the firm, they say. And because Viacom owns mostly content and little distribution, it relies on the quality of its programming to get access to the airwaves. A break-up deepens the risk that a powerful distribution firm, such as Comcast, might either dump its least popular content or, more likely, beat its prices down. Viacom's main defence against this happening—a powerful one—is to keep producing must-see programmes.

Another fundamental reason not to break up a media conglomerate is the supposed synergy between the

different bits. This notion has been partly discredited, but there remain some real examples. Owning CBS, for instance, means that cable and satellite-TV firms have to give something valuable in return for the right to broadcast the network's content. In the past, Viacom used this clout to help get distribution for new cable channels. Now, it says, it has extracted most of the value from these synergies.

A theory among some media insiders is that the split is simply Mr Redstone's way of dealing with succession. His plan until now was to pick Mr Freston or Mr Moonves to replace him as chief executive of the group, but now he can avoid choosing. This week he appointed his daughter, Shari Redstone, aged 50, to occupy a new position as non-executive vice-chairman. Messrs Freston and Moonves are expected to be named as chief executives of their respective companies in the coming months, and Mr Redstone will be chairman of both companies.

Of Viacom's offspring, Mr Freston's company has the hardest task. It has to produce the dizzying growth to justify Mr Redstone's decision. It plans to buy more cable networks, one or more video-gaming businesses and other digital-media businesses to help it grow.

Mr Freston's company has to produce the dizzying growth to justify Mr Redstone's decision

It will be able to count on loyal staff. “The people who work for Tom Freston admire him so much, it's like they're part of a cult,” says an executive at a broadcast-TV network in New York. As chairman of MTV Networks, a position which Mr Freston held until Viacom's former chief operating officer, Mel Karmazin, resigned last year, he managed to achieve the hardest thing in the media business: giving creative freedom to his employees and making consistently large profits at the same time. It is crucial, he says, to keep things vibrant in an enormous factory of a company. “Consolidation can lead to mediocrity,” he says. Running a smaller Viacom should suit him well.

Getting into digital media and video games will not be easy or cheap, however, since every other big media company wants to do the same. The strategy is a risky one, says a report by Richard Bilotti, media analyst at Morgan Stanley, an investment bank, especially given the fact that in the past Viacom made massive acquisitions that earned it less than its cost of capital. Late last year, the company wrote $10.9 billion off the balance-sheet value of its radio business and $7.1 billion off its outdoor-advertising business.

Some of the new Viacom's aim of growing on the internet can be realised organically. As a whole, Viacom earned $100m of income from the web last year, and expects to double that in 2005. This month MTV Networks announced the launch in Japan of “Flux”, an internet and mobile-phone subscription service selling clips of Japanese content as well as MTV Networks material, such as “Dirty Sanchez”, a show about a group of Welsh skateboarders. In April, MTV Networks launched MTV Overdrive, an internet-based entertainment and news service.

For the immediate future, the fortunes of Mr Freston's company will rest largely on the health of its long-established cable networks. Cable television has already seen its best growth from advertising and fees from cable and satellite-television firms. Few in the media industry, however, doubt that MTV Networks will continue to thrive. Despite being almost 24 years old, the original music channel, MTV, has managed to maintain its appeal to fickle teenagers and young adults in America, as well as in over 160 countries around the world.

One guiding creative principle at MTV Networks is that good ideas are allowed to rise from the bottom up. Also vital, says Mr Freston, is frequent consumer research and changing the channels' content before the popularity of a particular type of programming passes its peak. MTV started the reality-television genre back in 1992 with a programme called “The Real World” when it saw that back-to-back music videos were losing their novelty. But now the reality genre “has a sameness”, says Mr Freston, “and we're trying to move away from it”.

Right now, MTV Networks' consumer research also suggests that the generation gap between young people and their parents has mostly disappeared. The mood of “I want my MTV”, and friction between generations has passed, says Betsy Frank, executive vice-president of research and planning at Viacom. Today young people even see their parents as heroes, she says. Moreover in America and elsewhere most young people are extremely tolerant of sexuality, and indifferent to ethnic origin, says Mr Freston.

A priority for MTV Networks is to increase its profits overseas. At the moment, Viacom earns 16.5% of its revenue from outside America. Along with America's other big media firms (apart from News Corporation, which earns about two-fifths of its sales overseas), it relies heavily on its domestic market. Of its

overseas revenue (most of it from MTV Networks), 83% comes from Europe and Canada. MTV Networks wants to earn more from farther afield, especially in Asia.

Whether or not the new Viacom will be able to meet Mr Redstone's high expectations will also depend on Mr Freston's ability to turn around Paramount Pictures, which has had few hit movies in recent years compared with other studios. This year Viacom daringly hired as Paramount's new boss Brad Grey, a talent agent who previously ran his own management business but who has no experience of running a studio. Under Mr Grey, Paramount is trying to shed its reputation for creative conservatism, and is more welcoming to actors, directors and producers. It is also developing films for a younger audience and is working with MTV Films, whose successful movies include “Jackass: The Movie”. An easier way to generate cash will be to release more of its collection of films and TV shows on DVD. Up to now, Paramount has exploited its library far less than other studios.

“I am happy to be the underdog,” says Mr Moonves. Though responsible for the sort of traditional media that bloggers love to mock—including the business that has done more to drag down Viacom's growth than any other, radio—Mr Moonves is unlikely to sit back and remain content with slow growth. Indeed, one media executive predicts that the two companies are unlikely to stick to the growth characteristics that Mr Redstone seems to expect, and that CBS Corporation may do better than the market expects.

Here to infinity

Infinity Broadcasting, the radio division of Viacom, performed brilliantly when the government allowed the industry to consolidate during the late 1990s, which coincided with sharp increases in advertising revenue from the pharmaceutical industry and dotcom firms. But Mr Karmazin is said to have extracted all the growth he could while neglecting content. “What I found in the radio division was that they were starved and burning the furniture,” Mr Moonves told investors recently.

To stop listeners switching to satellite radio and their iPods, Infinity is replenishing its schedules. It is also rolling out a popular new format called “Jack” which it first launched at some stations more than two years ago. Designed to sound like an iPod on shuffle, “Jack FM” plays randomly from 1,200 familiar songs from the past three decades with less interruption from DJs. Another new initiative is the first podcasting radio station, with content taken entirely from listeners' submissions.

The other big chunk of the slower-growth business is CBS. For years, network TV's audience has been declining as viewers shift to cable. But CBS now has the biggest audience, and has trounced the long-established leader, General Electric's NBC. That is a huge achievement, even compared with the success of Viacom's niche cable-channels, says Michael Wolf, head of McKinsey's global media and entertainment practice, because CBS has had to win over a massive audience in middle America. CBS is also positioned well to grow in digital media. It has been particularly aggressive among the broadcast networks in using content from its shows to build a popular presence on the internet. Viewers of its “Big Brother” reality show, for instance, flock online to watch live webcasts.

Mr Redstone's rivals will be watching events closely to see which of the two companies does best, because they face very similar challenges. If the new two-part Viacom performs as expected, even the bloggers may have to admit that a stodgy old media firm can duck and weave like a digital upstart.

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Face value

Stemming the tide

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AFP

Can Rob Portman stop America turning its back on trade?

FREE traders rarely have much to celebrate in Washington, DC, these days. America's lawmakers seem ever more sceptical of globalisation, reluctant to agree to any new trade deals and gripped by a virulent Sinophobia. George Bush's team is trying all its weaponry in an uphill battle to get a free-trade pact with Central America through Congress. Import quotas have already been slapped on various Chinese textile products. If Beijing does not do something about its currency peg, the risks are that more and nastier protectionism will follow.

Although the shouting match with Europe over aircraft subsidies has calmed down as both sides have sent their complaints to the World Trade Organisation, transatlantic trade relations are still testy. A bilateral EU-US trade summit next week will yield little more than hot air. And with the clock ticking on the Doha round of global trade talks, serious political breakthroughs are nowhere in sight. Far from showing great leadership on global trade, a more frequent question in Washington is whether America can avoid slipping backwards.

Whether that happens depends largely on Rob Portman, a close friend of the president and formerly a top Republican congressman, who recently took over as America's trade representative. Mr Portman succeeded Bob Zoellick, who was widely respected for his formidable intellect and negotiating skills, but was never particularly close to lawmakers. Mr Portman, by contrast, is less self-consciously intellectual (he happily admits that Milton's “Paradise Lost” is a “turgid” read and one of his least favourite books). His commitment to free trade is more instinctive and less analytic than Mr Zoellick's. But as a lawmaker who focused on trade as well as playing important behind-the-scenes roles in many of Mr Bush's first-term legislative victories, such as that over tax cuts, Mr Portman knows Congress and its attitudes to trade better than almost anyone.

More surprising, he is that rare politician whom colleagues from both parties seem to respect and like. It is hard to find a Democrat with a bad word to say about him—no mean achievement when most can barely mention Mr Bush without scowling. With a ready smile, Mr Portman exudes both affability and competence. He is the kind of politician who is quick to grasp complicated issues and even quicker to

show you pictures of his children or enthuse about his passion for white-water kayaking.

Equally promising, Mr Portman is a card-carrying internationalist from a legislature where too many people do not have passports. He is proud of having spent time in Sweden on a cultural exchange as a child, and on a French farm as a student (“one of the great culinary experiences of my life”). He speaks passable Spanish and French and is a frequent attendee at Davos, the annual gathering of the global elite. An internationalist Republican free-trading former legislator who commands bipartisan respect and has close connections with the White House: that is a compelling resumé for America's top man on trade.

But can the nice guy deliver?

Mr Portman's success will send strong signals about how seriously the Bush administration intends to fight both against protectionism and in favour of freer trade. The first test is at hand: the Central American Free Trade Agreement (CAFTA), a small but politically charged regional trade deal. Although Mr Portman had nothing to do with its conception—the deal was signed a year ago—securing its passage through Congress will be an early test of his effectiveness. Mr Bush has declared CAFTA to be his top trade priority. Mr Portman has spent much of the past month on Capitol Hill persuading his Republican colleagues to stand up to the sugar lobby—which vehemently opposes the deal—and assiduously trying to convince free-trade Democrats to vote on principle rather than partisanship.

If CAFTA fails, Mr Portman's clout—as well as America's trade strategy—will be severely damaged. If it succeeds, the outlook is rosier, although the challenges are still huge. The Doha round of global trade talks sorely lacks momentum. With six months to go until a big meeting of trade ministers in Hong Kong, at which the broad outlines of the whole trade deal must be agreed, there are scant signs of serious progress. Mr Portman seems genuinely committed to Doha and tries his best to sound upbeat about it, touting recent technical breakthroughs on how to measure farm tariffs and cut barriers on industrial goods. But his vocabulary is telling. He muses openly about whether it is more apt to talk about “salvaging” the talks, “kick-starting” them or “breathing new life” into them. None of those verbs suggest he sees a big political deal at hand.

Worse, even with a CAFTA victory, Mr Portman will not be able to focus exclusively on successfully completing Doha. Much of his time will be spent dealing with congressional pressure, particularly on China. With the trade deficit set to rise, and Beijing unlikely to introduce the radical currency appreciation for which American lawmakers are clamouring, tougher anti-China bills are virtually certain to appear. How will Mr Portman react? For all his instinctive commitment to free trade and his determination to educate Americans about the dangers of protectionism, he has a politician's mindset when it comes to China. He has promised a “top-to-bottom review” of trade policy towards Beijing. He talks about the “critical” importance of making sure trade is “more balanced”. And he is adamant that, while China's currency may be a political football, it is one with an obvious economic impact. “When the dollar goes down we get a big benefit on trade with the EU, but not with the country that has the world's largest trade surplus with us,” he complains. Compared with many on Capitol Hill such views are distinctly moderate. But they also suggest that Washington's China-bashing is not about to end.

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The global housing boom

In come the waves

Jun 16th 2005
From The Economist print edition

The worldwide rise in house prices is the biggest bubble in history. Prepare for the economic pain when it pops

NEVER before have real house prices risen so fast, for so long, in so many countries. Property markets have been frothing from America, Britain and Australia to France, Spain and China. Rising property prices helped to prop up the world economy after the stockmarket bubble burst in 2000. What if the housing boom now turns to bust?

According to estimates by *The Economist*, the total value of residential property in developed economies rose by more than $30 trillion over the past five years, to over $70 trillion, an increase equivalent to 100% of those countries' combined GDPs. Not only does this dwarf any previous house-price boom, it is larger than the global stockmarket bubble in the late 1990s (an increase over five years of 80% of GDP) or America's stockmarket bubble in the late 1920s (55% of GDP). In other words, it looks like the biggest bubble in history.

The Economist's house-price indices

% change:

	on a year earlier		1997-2005
	Q1 2005*	Q1 2004	
South Africa	23.6	28.1	244
Hong Kong	19.0	17.4	-43
Spain	15.5	17.2	145
France	15.0	14.7	87
New Zealand	12.5	23.3	66
United States	12.5	8.4	73
Denmark	11.3	6.0	58
Sweden	10.0	7.7	84
China	9.8	7.7	na
Italy	9.7	10.8	69
Belgium	9.4	8.8	71
Ireland	6.5	13.2	192
Britain	5.5	16.9	154
Canada	5.2	5.7	47
Singapore	2.0	-1.5	na
Netherlands	1.9	5.5	76
Switzerland	1.0	3.4	12
Australia	0.4	17.9	114
Germany	-1.3†	-0.8‡	-0.2
Japan	-5.4	-6.4	-28

*Or latest †2004 average ‡2003 average

Sources: ABSA; Bulwien; ESRI; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; government offices

The global boom in house prices has been driven by two common factors: historically low interest rates have encouraged home buyers to borrow more money; and households have lost faith in equities after stockmarkets plunged, making property look attractive. Will prices now fall, or simply flatten off? And in either case, what will be the consequences for economies around the globe? The likely answers to all these questions are not comforting.

The increasing importance of house prices in the world economy prompted *The Economist* to start publishing a set of global house-price indices in 2002 (see article). These now cover 20 countries, using data from lending institutions, estate agents and national statistics. Our latest quarterly update shows that home prices continue to rise by 10% or more in half of the countries (see table). America has seen one of the biggest increases in house-price inflation over the past year, with the average price of homes jumping by 12.5% in the year to the first quarter. In California, Florida, Nevada. Hawaii, Maryland and Washington, DC, they soared by more than 20%.

In Europe, prices have long been at dizzy heights in Ireland and Spain, but over the past year have also spurted at rates of 9% or more in France, Italy, Belgium, Denmark and Sweden. Both France (15%) and Spain (15.5%) have faster house-price inflation than the United States.

By contrast, some housing booms have now fizzled out. In Australia, according to official figures, the 12-month rate of increase in house prices slowed sharply to only 0.4% in the first quarter of this year, down from almost 20% in late 2003. Wishful thinkers call this a soft landing, but another index, calculated by the Commonwealth Bank of Australia, which is based on prices when contracts are agreed rather than at settlement, shows that average house prices have actually fallen by 7% since 2003; prices in once-hot Sydney have plunged by 16%.

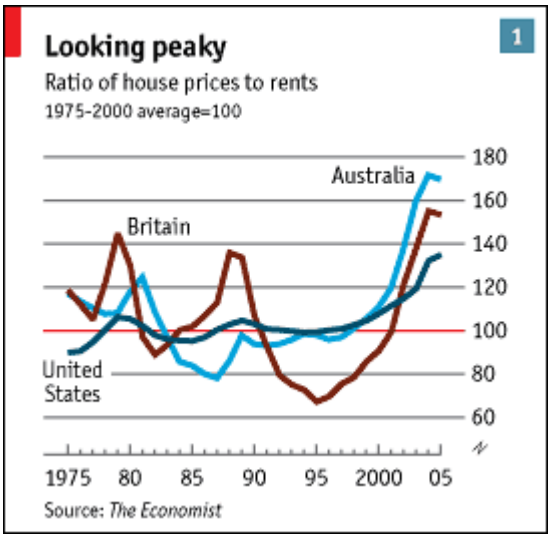
Britain's housing market has also cooled rapidly. The Nationwide index, which we use, rose by 5.5% in the year to May, down from 20% growth in July 2004. But once again, other surveys offer a gloomier picture. The Royal Institution of Chartered Surveyors (RICS) reports that prices have fallen for ten consecutive months, with a net balance of 49% of surveyors reporting falling prices in May, the weakest number since 1992 during Britain's previous house-price bust. The volume of sales has slumped by one-third compared with a year ago as both sellers and buyers have lost confidence in house valuations. House-price inflation has also slowed significantly in Ireland, the Netherlands and New Zealand over the

past year.

Since 1997, home prices in most countries have risen by much more in real terms (ie, after adjusting for inflation) than during any previous boom. (The glaring exceptions are Germany and Japan, where prices have been falling.) American prices have risen by less than those in Britain, yet this is still by far the biggest boom in American history, with real gains more than three times bigger than in previous housing booms in the 1970s or the 1980s.

The most compelling evidence that home prices are over-valued in many countries is the diverging relationship between house prices and rents. The ratio of prices to rents is a sort of price/earnings ratio for the housing market. Just as the price of a share should equal the discounted present value of future dividends, so the price of a house should reflect the future benefits of ownership, either as rental income for an investor or the rent saved by an owner-occupier.

Calculations by *The Economist* show that house prices have hit record levels in relation to rents in America, Britain, Australia, New Zealand, France, Spain, the Netherlands, Ireland and Belgium. This suggests that homes are even more over-valued than at previous peaks, from which prices typically fell in real terms. House prices are also at record levels in relation to incomes in these nine countries.



America's ratio of prices to rents is 35% above its average level during 1975-2000 (see chart 1). By the same gauge, property is “overvalued” by 50% or more in Britain, Australia and Spain. Rental yields have fallen to well below current mortgage rates, making it impossible for many landlords to make money.

To bring the ratio of prices to rents back to some sort of fair value, either rents must rise sharply or prices must fall. After many previous house-price booms most of the adjustment came through inflation pushing up rents and incomes, while home prices stayed broadly flat. But today, with inflation much lower, a similar process would take years. For example, if rents rise by an annual 2.5%, house prices would need to remain flat for 12 years to bring America's ratio of house prices to rents back to its long-term norm. Elsewhere it would take even longer. It seems more likely, then, that prices will fall.

A common objection to this analysis is that low interest rates make buying a home cheaper and so justify higher prices in relation to rents. But this argument is incorrectly based on nominal, not real, interest rates and so ignores the impact of inflation in eroding the real burden of mortgage debt. If real interest rates are permanently lower, this could indeed justify higher prices in relation to rents or income. For example, real rates in Ireland and Spain were reduced significantly by these countries' membership of Europe's single currency—though not by enough to explain all of the surge in house prices. But in America and Britain, real after-tax interest rates are not especially low by historical standards.

Betting the house

America's housing market heated up later than those in other countries, such as Britain and Australia, but it is now looking more and more similar. Even the Federal Reserve is at last starting to fret about what is happening. Prices are being driven by speculative demand. A study by the National Association of Realtors (NAR) found that 23% of all American houses bought in 2004 were for investment, not owner-

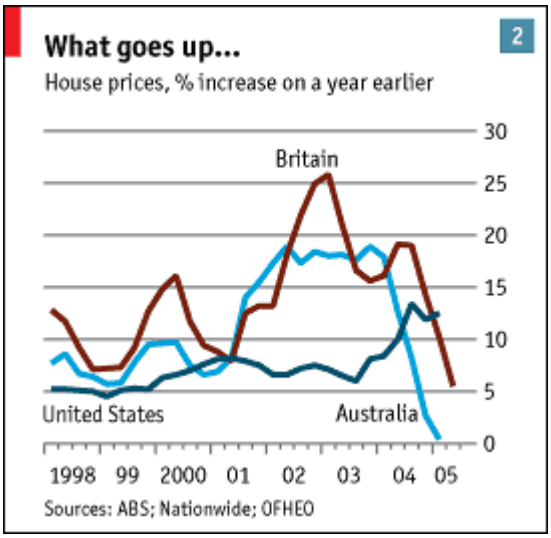
occupation. Another 13% were bought as second homes. Investors are prepared to buy houses they will rent out at a loss, just because they think prices will keep rising—the very definition of a financial bubble. “Flippers” buy and sell new properties even before they are built in the hope of a large gain. In Miami, as many as half of the original buyers resell new apartments in this way. Many properties change hands two or three times before somebody finally moves in.

New, riskier forms of mortgage finance also allow buyers to borrow more. According to the NAR, 42% of all first-time buyers and 25% of all buyers made no down-payment on their home purchase last year. Indeed, homebuyers can get 105% loans to cover buying costs. And, increasingly, little or no documentation of a borrower's assets, employment and income is required for a loan.

Interest-only mortgages are all the rage, along with so-called “negative amortisation loans” (the buyer pays less than the interest due and the unpaid principal and interest is added on to the loan). After an initial period, payments surge as principal repayment kicks in. In California, over 60% of all new mortgages this year are interest-only or negative-amortisation, up from 8% in 2002. The national figure is one-third. The new loans are essentially a gamble that prices will continue to rise rapidly, allowing the borrower to sell the home at a profit or refinance before any principal has to be repaid. Such loans are usually adjustable-rate mortgages (ARMs), which leave the borrower additionally exposed to higher interest rates. This year, ARMs have risen to 50% of all mortgages in those states with the biggest price rises.

The rapid house-price inflation of recent years is clearly unsustainable, yet most economists in most countries (even in Britain and Australia, where prices are already falling) still cling to the hope that house prices will flatten rather than collapse. It is true that, unlike share prices, house prices tend to be somewhat “sticky” downwards. People have to live somewhere and owners are loth to accept a capital loss. As long as they can afford their mortgage payments, they will stay put until conditions improve. The snag is that eventually some owners have to sell—because of relocation, or job loss—and they will be forced to accept lower prices.

Indeed, a drop in nominal prices is today more likely than after previous booms for three reasons: homes are more overvalued; inflation is much lower; and many more people have been buying houses as an investment. If house prices stop rising or start to fall, owner-occupiers will largely stay put, but over-exposed investors are more likely to sell, especially if rents do not cover their interest payments. House prices will not collapse overnight like stockmarkets—a slow puncture is more likely. But over the next five years, several countries are likely to experience price falls of 20% or more.



While America's housing market is still red hot, others—in Britain, Australia and the Netherlands—have already cooled (see chart 2). What lessons might they offer the United States?

The first is that, contrary to conventional wisdom, it does not require a trigger, such as a big rise in interest rates or unemployment, for house prices to decline. British home prices started to fall in the summer of 2004 after the Bank of England raised rates by a modest one and a quarter percentage points. Since 2002, the Reserve Bank of Australia has raised rates by exactly the same amount and unemployment is at a 30-year low, yet home prices have fallen. The Federal Reserve's gradual increase in rates by two percentage-points over the past year has done little to scare away buyers, because most

still have fixed-rate mortgages and long-term bond yields have remained unusually low. But as more Americans have been resorting to ARMs, so the housing market is becoming more vulnerable to rising rates.

Rung at the bottom

British and Australian prices have stalled mainly because first-time buyers have been priced out of the market and demand from buy-to-let investors has slumped. British first-timers now account for only 29% of buyers, down from 50% in 1999. And, according to the National Association of Estate Agents, buy-to-let purchases are running 50% lower than a year ago. As prices become more and more heady in America, the same will happen there.

British experience also undermines a popular argument in America that house prices must keeping rising because there is a limited supply of land and a growing number of households. As recently as a year ago, it was similarly argued that the supply of houses in Britain could not keep up with demand. But as the expectation of rising prices has faded, demand has slumped. According to RICS, the stock of houses for sale has increased by one-third over the past year. America has faster population growth than Britain, but its supply of housing has also been rising rapidly. Economists at Goldman Sachs point out that residential investment is at a 40-year high in America, yet the number of households is growing at its slowest pace for 40 years. This will create excess supply.

Another mantra of housing bulls in America is that national average house prices have never fallen for a full year since modern statistics began. Yet outside America, many countries have at some time experienced a drop in average house prices, such as Britain and Sweden in the early 1990s and Japan over the past decade. So why should America be immune? Alan Greenspan, chairman of America's Federal Reserve, accepts that there are some local bubbles, but dismisses the idea of a national housing bubble that could harm the whole economy if it bursts. America has in the past seen sharp regional price declines, for example in Boston, Manhattan and San Francisco in the early 1990s. This time, with prices looking overvalued in more states than ever in the past, average American prices may well fall for the first time since the Great Depression.

But even if prices in America do dip, insist the optimists, they will quickly resume their rising trend, because real house prices always rise strongly in the long term. Robert Shiller, a Yale economist, who has just updated his book “Irrational Exuberance” (first published on the eve of the stockmarket collapse in 2000), disagrees. He estimates that house prices in America rose by an annual average of only 0.4% in real terms between 1890 and 2004. And if the current boom is stripped out of the figures, along with the period after the second world war when the government offered subsidies for returning soldiers, artificially inflating prices, real house prices have been flat or falling most of the time. Another sobering warning is that after British house prices fell in the early 1990s, it took at least a decade before they returned to their previous peak, after adjusting for inflation.

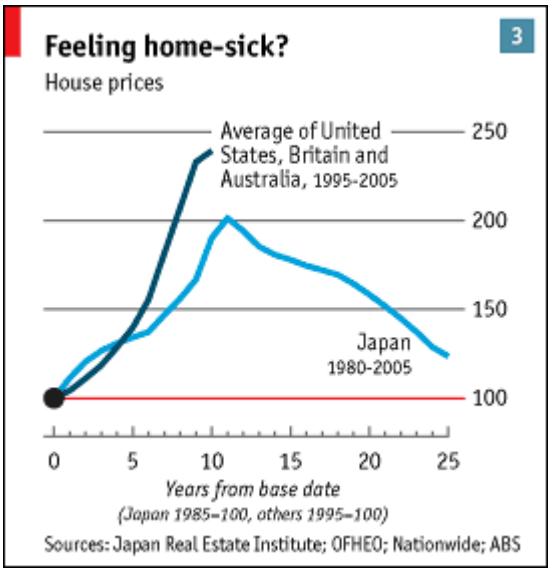
Another worrying lesson from abroad for America is that even a mere levelling-off of house prices can trigger a sharp slowdown in consumer spending. Take the Netherlands. In the late 1990s, the booming Dutch economy was heralded as a model of success. At the time, both house prices and household credit were rising at double-digit rates. The rate of Dutch house-price inflation then slowed from 20% in 2000 to nearly zero by 2003. This appeared to be the perfect soft landing: prices did not drop. Yet consumer spending declined in 2003, pushing the economy into recession, from which it has still not recovered. When house prices had been rising, borrowing against capital gains on homes to finance other spending had surged. Although house prices did not fall, this housing-equity withdrawal plunged after 2001, removing a powerful stimulus to spending.

Housing-equity withdrawal has also fallen sharply over the past year in Britain and Australia, denting household spending. In Australia, the 12-month rate of growth in retail sales has slowed from 8% to only 1.8% over the past year; GDP growth has halved to 1.9%. In Britain, too, a cooling of the housing market has been accompanied by an abrupt slowdown in consumer spending. If, as seems likely, home prices continue to fall in both countries, spending will be further squeezed.

Even a modest weakening of house prices in America would hurt consumer spending, because homeowners have been cashing out their capital gains at a record pace. Goldman Sachs estimates that total housing-equity withdrawal rose to 7.4% of personal disposable income in 2004. If prices stop rising, this “income” from capital gains will vanish.

And after the gold rush?

The housing market has played such a big role in propping up America's economy that a sharp slowdown in house prices is likely to have severe consequences. Over the past four years, consumer spending and residential construction have together accounted for 90% of the total growth in GDP. And over two-fifths of all private-sector jobs created since 2001 have been in housing-related sectors, such as construction, real estate and mortgage broking.



One of the best international studies of how house-price busts can hurt economies has been done by the International Monetary Fund. Analysing house prices in 14 countries during 1970-2001, it identified 20 examples of “busts”, when real prices fell by almost 30% on average (the fall in nominal prices was smaller). All but one of those housing busts led to a recession, with GDP after three years falling to an average of 8% below its previous growth trend. America was the only country to avoid a boom and bust during that period. This time it looks likely to join the club.

Japan provides a nasty warning of what can happen when boom turns to bust. Japanese property prices have dropped for 14 years in a row, by 40% from their peak in 1991. Yet the rise in prices in Japan during the decade before 1991 was less than the increase over the past ten years in most of the countries that have experienced housing booms (see chart 3). And it is surely no coincidence that Japan and Germany, the two countries where house prices have fallen for most of the past decade, have had the weakest growth in consumer spending of all developed economies over that period. Americans who believe that house prices can only go up and pose no risk to their economy would be well advised to look overseas.

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About sponsorship

Morgan Stanley

UnfulPhilled

Jun 16th 2005 | NEW YORK
From The Economist print edition

A long campaign of criticism has toppled Philip Purcell, Morgan Stanley's chief executive. Where next for the Wall Street firm?

FITTINGLY, the departure of Philip Purcell from the chief executive's job at Morgan Stanley is creating as much muddle as his tenure. On June 13th, Mr Purcell announced what many shareholders and remaining employees had desperately wanted to hear: he was going. The cheers were muted, however, by the vagueness about when: sometime before the annual shareholders' meeting next spring, after his successor has been appointed.

Pressure on Mr Purcell—and Morgan Stanley's hitherto slavishly supportive board—had been mounting for months. A group of former executives had been calling for his head, especially loudly since a series of reorganisations led to the departure of five members of the firm's management committee. Institutional investors and hedge funds shorting its shares saw incompetence; those buying smelled blood. The firm's long-term financial performance, while not bad, has been worse than those of its primary competitors. Defections were all too frequent. Its bellicose legal strategy, run by a close associate of Mr Purcell's, recently yielded a $1.5 billion court defeat that had far less to do with the merits of the claims against the bank than with a judge's perception that its defence hinged on burying evidence.

None of this might have mattered. Investment banks routinely go through times when they lose a lot of good people. Goldman Sachs has seen perhaps 70% of its partners go since its initial public offering in 1999, including two putative successors to its current chief executive. Merrill Lynch turned over its entire management in late 2001. Mr Purcell, though, could not staunch the loss of disaffected employees or silence the carping about his strategy.

His fate may have been sealed by two minor events: an uninspired presentation to investors on May 10th that raised doubts about his vision and strategy; and this week's warning about disappointing second-quarter profits. Unhelpfully good results from Lehman Brothers and Bear Stearns, reported after Mr Purcell said he was on his way, served only to point up Morgan Stanley's relative failings.

So, what's plan B?

Morgan Stanley's share price jumped on the news of Mr Purcell's departure, but enthusiasm then petered out. The way ahead is anything but clear. There is no heir apparent. It thus seems that neither of the two highly regarded co-presidents he appointed recently, Zoe Cruz and Stephen Crawford, is yet thought ready to lead the firm. Morgan Stanley also indicated that none of the executives who have departed recently would be invited back to take the top job. It appears, therefore that none of the people who know the firm best is in the running. The uncertainty about the succession may give some employees a good incentive to choose their own boss, at another firm, rather than wait to see who Morgan Stanley's board chooses for them. And the rebel alumni may yet try to cause trouble for the board.

Morgan Stanley's instability has been a joy to watch for competing firms, who have enjoyed the way Mr Purcell has run what was once the most prominent franchise on Wall Street. Some rivals have been able to poach experienced, talented people. And the lists of departing Morgan Stanleyites in the newspapers have drawn attention away from their own troubles.

To be sure, some of those departing have overblown reputations and others are merely pretending to have left, having in fact been fired. Still, many were valuable. Fitch, a credit-rating agency, voiced “dismay” at the stream of departures in reaffirming its negative outlook after the news of Mr Purcell's departure. None of the big Wall Street firms that have faltered in the past two decades—Dillon Read, Drexel Burnham Lambert, E.F. Hutton, Salomon Brothers and Kidder Peabody—did so because the competition roasted them. For one reason or another, all imploded. Even the strongest firm is a delicate combination of flighty clients and flightier talent. Morgan Stanley is highly profitable, and looks far from catastrophe. And yet investment banks can unravel rapidly.

Whoever takes Mr Purcell's place will have to be capable of halting the defections. That requires not just the support of the board (Mr Purcell enjoyed that in spades) but the confidence of the investment bankers. The ideal candidate would be able to understand arcane trading strategies, charm clients and satisfy giant egos more cheaply than competitors could. Few are born with these qualities, and no management training programme exists.

Just as important, the new boss will have to define Morgan Stanley's strategy. Conventional wisdom has it that the investment bank erred in 1997 when it merged with Dean Witter, a retail broking and credit-card company. Returns on the Dean Witter end of the business are poor, and Mr Purcell said recently that the credit-card business would be spun off. Yet Mr Purcell considered himself a strategic visionary who saw the value of broadening the distribution of financial products. At Sears, Roebuck, a retailer, he started the Discover credit card and tried to combine the sale of “socks and stocks” by buying a retail broker, Dean Witter. Having failed to make the strategy work at Sears, he carried it over into Dean Witter's merger with Morgan Stanley, reasoning that linking the underwriting of securities with their sale to the public had to have some value.

Arguably, after the merger, profits from Dean Witter provided money for Morgan Stanley's investment-banking businesses. These days, though, it is the investment bank that makes the money. A question left unanswered is whether the combination failed because the two parts were simply incompatible—as the firm's disgruntled alumni believe—or because of poor management. Only in the past two months, under Ms Cruz and Mr Crawford, has full integration begun.

Difficult decisions have yet to be made about which businesses fit together and which do not. For example, Dean Witter's strategy of offering mutual funds managed by many advisers as well as in-house products has attracted outrage and litigation; then again, a large salesforce helps distribution. Awkwardly, the better the argument for keeping the firm broad, the better the case for joining forces with a retail and commercial bank. The names most cited are HSBC and Bank of America. The top executives at Morgan Stanley oppose this, but whether they can avoid a takeover may come down to how well they operate without Mr Purcell. The sooner he leaves, the sooner the test begins.

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About sponsorship

European bank mergers

Profumo's sense

Jun 16th 2005 | FRANKFURT
From The Economist print edition

Will an Italian-German marriage encourage others?

AFP

Profumo and Rampl, European partners

BANKERS are not quite expecting a wave of copy-cat mergers across Europe. But the takeover, announced on June 12th, by UniCredit, Italy's largest bank, of HVB Group, Germany's second-biggest, has set the rumour mills turning.

Until this daring marriage, which will create continental Europe's fourth-biggest bank, the accepted wisdom had been that the mere sniff of a cross-border deal was enough to punish the share prices of both parties. Yet by the time Alessandro Profumo, UniCredit's chief executive, and Dieter Rampl, his counterpart at HVB, hugged each other in front of cameras in Munich, the German bank's share price had soared, while the Italian one's had at least held steady.

Four years ago, when Mr Profumo was contemplating a similar deal with Commerzbank, another German bank, the share prices of both plummeted. Last year, Dexia, a Franco-Belgian bank group, and Sanpaolo IMI, its putative Italian partner, saw their shares suffer as investors turned up their noses at their merger proposal. Mr Profumo sensed that the mood started to change with last year's purchase of Abbey, Britain's sixth-biggest bank, by Spain's Santander Central Hispano.

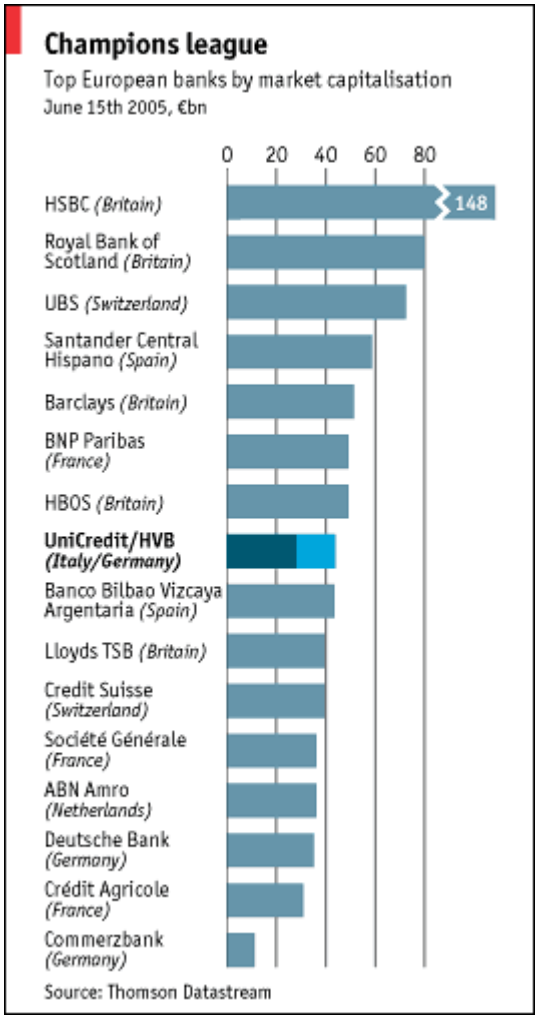
UniCredit will pay around €19 billion ($23 billion) for a full takeover of HVB and its listed affiliates, Bank Austria and BPH, a Polish bank. The group will be a strong force in northern Italy, Bavaria, Germany's southernmost state, the northern German city of Hamburg, Austria and four countries in central and eastern Europe. About 9,000 jobs are expected to go because of overlaps, especially in Poland. In Germany 2,000 jobs will be lost, but through natural attrition, in addition to 2,200 already planned.

Mr Profumo, who is set to be the new bank's chief executive, and Mr Rampl, the prospective chairman, argue that the combination of stable business in western Europe and high growth farther east is a good business mix. The new group's biggest challenge will be in Germany, where HVB has struggled with a fragmented retail market and a legacy of bad corporate and property loans. Perhaps its biggest weakness is its thin capitalisation: a tier-one capital ratio of just over 5%. That puts it at the bottom end of the range for banks with a market value of €40 billion or more.

Peter Wuffli, chief executive of UBS, a big Swiss bank with a market value of SFr110 billion ($86 billion) and a tier-one ratio of 11.5%, has doubts about the economics of the UniCredit-HVB merger, and the challenge of dealing with two different languages and cultures. But he acknowledges two factors that may help it work: HVB's urgent need to merge (it was seen by the market as “on the ropes”); and Mr Profumo's track record in forging UniCredit out of several smaller Italian banks. Mr Profumo also believes he enjoys first-mover advantage: no other merger spanning western and eastern Europe could expect such a good fit, he says. Mr Rampl believes that the success of Bank Austria, which HVB bought in 2000, shows that cross-border mergers can indeed work.

What might the next such move be? In the past, Italy's central bank has frowned on foreign banks wanting to buy in Italy. Now that UniCredit has forayed abroad, the central bank might look more benignly on one of two current bids, by the Netherlands' ABN Amro and Spain's Banco Bilbao Vizcaya Argentaria. The

most pressure, though, may be felt by Germany's two remaining big, independent private-sector banks, Deutsche Bank and Commerzbank.



Commerzbank has spent the past year cutting its costs in investment banking and trying to go it alone as a middle-tier corporate and retail bank. But it will surely merge or be taken over soon. Rumours have linked it with Deutsche and even with WestLB, a public-sector bank. A newly elected centre-right government in North Rhine-Westphalia, WestLB's home state, says it would like to sell its 25% stake. However, the most likely buyer would be foreign—perhaps one of the big French banks, or Royal Bank of Scotland.

Deutsche's future is less easy to predict. One senior banker says that UniCredit's purchase of HVB “will force Deutsche Bank to decide what it wants to be.” Deutsche demurred last year when offered the chance to take over Postbank, a retail bank owned by Deutsche Post. Now Josef Ackermann, Deutsche's chief executive, has told *Handelsblatt*, a German business newspaper, that Postbank would have been a good fit strategically. There are signs that Deutsche is changing tack and aiming to expand at home and abroad, though still straining to keep its return on equity at around 25%, close to that of its chosen peer group of global banks. Deutsche is among those interested in Banca Comerciala Romana, Romania's biggest bank, the last big bank privatisation in central Europe. Although Deutsche has operations in several central European countries, this would be its first big acquisition in the region. It is “lobbying hard in Bucharest”, according to a competitor.

But for Mr Ackermann a big cross-border merger in western Europe would be another matter. A prerequisite would be a more integrated European financial market. And then he would prefer a merger of equals, in which two leading banks combine to make a bigger platform. However, he notes that because such mergers bring no immediate cost savings, analysts and investors tend to be sceptical about them.

Mr Profumo may have caught a change of mood in Europe among investors, national regulators and the public. He has managed to buy HVB without provoking howls of German protest; Mr Ackermann was vilified in 2003 when it was rumoured that he might sell Deutsche to America's Citigroup. Brussels bureaucrats have long urged greater integration of European financial markets, while home regulators and the banks themselves have found many ways to protect their home turf. Now Santander's purchase of Abbey, which seemed a flash in the pan, looks more likely to become a trend.

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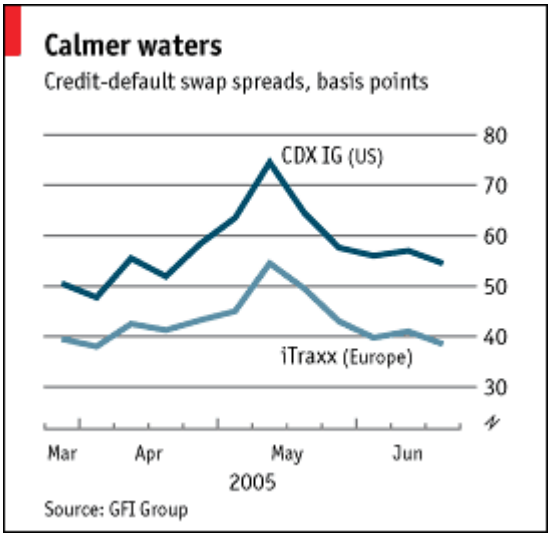
About sponsorship

Credit markets

Even keel?

Jun 16th 2005
From The Economist print edition

Markets are recovering nicely from last month's battering. So far, anyway



THIS time last month, darkness was descending on the maze of bonds, derivatives and structured finance in the credit markets. The biggest downgrade of corporate debt to junk in history—of General Motors (GM) and Ford—was wreaking havoc, despite having been expected.

Prices of the riskiest tranches of CDOs (collateralised debt obligations, bundles of credit sold off in bits) fell sharply, as investors tried to dump their exposure to likelier default. The price of credit-default swap (CDS) protection spiked upwards. Virtually all higher-yielding bonds lost ground to supposedly risk-free Treasuries. Hedge funds that had borrowed and bet wrong were reckoned to be in deep trouble. So were the investment banks that had financed and bet alongside them. The only question seemed to be whether the contagion could be contained.

What happened? On May 31st, GM was duly transferred from investment-grade bond indices to junkland, and the Earth did not stop spinning. Spreads on Merrill Lynch's high-grade American corporate index have tightened, from 111 basis points (one-hundredths of a percentage point) over Treasuries in mid-May to 95. Spreads on junk bonds have also narrowed, and by more: from their peak of 458 basis points to 383. GM's benchmark bond due in 2033 is now selling for more than it did before the downgrade. And, as the chart shows, spreads on credit-default swaps in both America and Europe are nearing their old levels.

Does this mean that greed is good and risk is back? Only in part. It makes sense for the investment-grade bond index to do better once its worst credit has dropped out. GM's bonds are benefiting as short-sellers who bet against the firm have had to cover their positions in the wake of somewhat better recent news. Money managers who track high-yield indices are also having to buy the bonds, though few will seek to mimic GM's uncapped weight in the high-yield indices (6.4% in America and 20.3% in Europe).

All in all, “the market has held up better than we expected,” says Michael Fuhrman, North American head of electronic trading at GFI Group, an interbroker dealer in credit swaps. “Despite the turbulence, with moves five or six standard deviations away from what many models predicted, the CDS market enabled investors to transfer risk with no systemic problems.”

More trouble may lurk among CDOs, however. While the riskiest (“equity”) tranches are recovering from their mid-May low, they are far weaker than in the first quarter. Hedge funds and investment banks are still battling to sell, and finding few buyers. “The problem of positions hasn't been solved, and people are about as long as they were before,” says Roberto Fumagalli, a credit strategist at Citigroup. “So the market will remain unbalanced under the surface for six months and possibly much longer.”

The relative outperformance of the next riskiest, “mezzanine” tranches may conceal future problems too. Louise Purtle, of CreditSights, a New York research firm, points out that many holders are European and Asian institutions that found bespoke CDOs a useful way to get the higher yields on semi-louche corporate bonds while respecting requirements to hold investment-grade paper. They are usually long-term investors and are not required to mark their positions to market, so they have been able to weather day-to-day fluctuations in prices better than leveraged hedge funds. But the creditworthiness of some underlying names has lessened, reckons Ms Purtle. A change in accounting standards or a more critical review by rating agencies could bring these risks, and potential losses, into the open.

For all the reasonably robust performance so far, there is a fragile feeling in the air. Junk-bond spreads are still 100 basis points wider than they were at the beginning of the year, which suggests that risk aversion is about more than carmakers. Although economic conditions remain broadly favourable, credit quality is beginning to decline. Standard & Poor's, a rating agency, warns that the number of fallen angels (firms downgraded from investment status) is greater this year than last, and that potential Lucifers are also more numerous. Surveys in America and Europe show that banks' lending standards have got laxer as they fall over themselves to lend to companies. The markets seem to have ridden out one shock fairly easily. But if the credit cycle has turned nasty?

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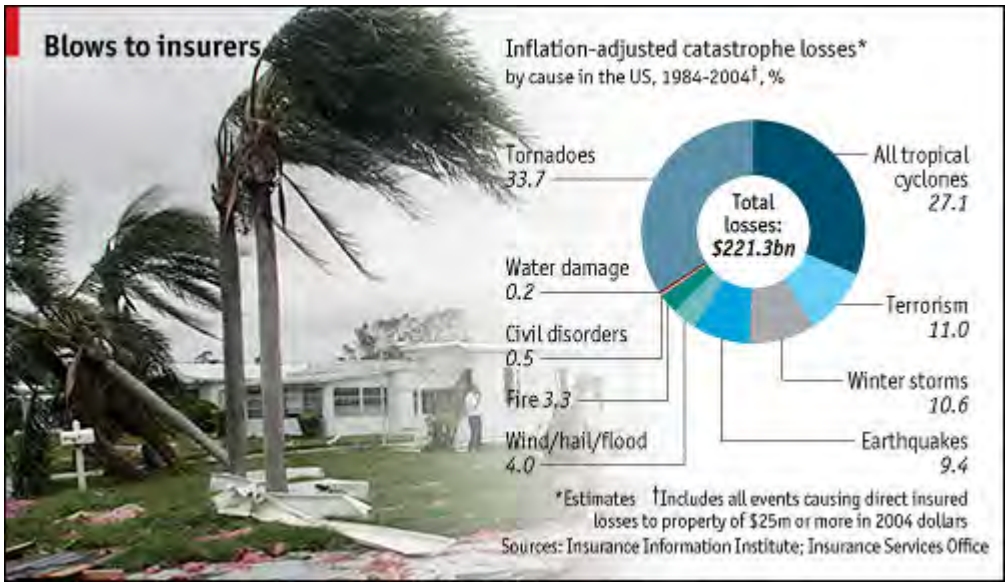
Property insurance

Taking cover

Jun 16th 2005
From The Economist print edition


Blows to insurers
Inflation-adjusted catastrophe losses*
by cause in the US, 1984-2004†, %
Tornadoes 33.7
All tropical cyclones 27.1
Total losses: $221.3bn
Water damage 0.2
Terrorism 11.0
Civil disorders 0.5
Winter storms 10.6
Fire 3.3
Earthquakes 9.4
Wind/hail/flood 4.0
*Estimates †Includes all events causing direct insured losses to property of $25m or more in 2004 dollars
Sources: Insurance Information Institute; Insurance Services Office

Insurers and their policyholders batten down the hatches as America's hurricane season begins

FLORIDIANS and their insurers heaved a collective sigh of relief this week as Arlene, the first big tropical storm of the season, left them relatively unscathed. Residents of the Sunshine State and their neighbours in America's south-east are still recovering from damage inflicted in 2004, when an improbable four hurricanes hit within six weeks, generating a record 2.2m insurance claims.

You may still worry about Aunt Tilly in Fort Lauderdale, but should anyone shed a tear for America's insurers? No: the property-and-casualty (P&C) insurance industry looks impressively fit, given last year's record $27.3 billion in insured natural-disaster losses, of which 83% were hurricane-related. The P&C industry “has just experienced its most remarkable recovery in recent history,” says Robert Hartwig of the Insurance Information Institute (III), an industry group. The sector produced an underwriting profit of $5 billion in 2004, its first since 1978. Given the improving picture, average premiums are expected to flatten or even decline.

The turnaround did not happen overnight. Throughout the 1990s, increasingly severe losses (Hurricane Andrew, the Northridge earthquake, tornadoes, wildfires and such) squeezed insurers. Then came the terrorist attacks of 2001. Between 1990 and 2002, says the III, home insurers paid out $1.17 in losses and expenses for every dollar of premiums. Since then, the sector has gradually raised prices and has shown more underwriting discipline. By 2003, payouts had fallen to $0.98 per dollar of premiums, though last year's storms pushed payouts back up to $1.01. The lacklustre investment climate in recent years has encouraged this greater discipline, since investments are no longer guaranteed to top up results.

The industry's attractiveness is underscored by interest from abroad. Lloyd's of London now does more than one-third of its global business in America and looks to increase its presence in the P&C market there further, despite losses of $2.3 billion in last year's hurricanes.

But Florida stands in stark contrast to this generally positive picture. The hurricanes of 2004 erased the past seven years of profits for the state's homeowners' insurance industry. One small insurer failed, the state-run home-insurance fund of last resort was plunged into crisis, and Allstate, America's second-

largest P&C insurer, decided to discontinue writing such policies in Florida. The III estimates that the price of homeowners' insurance will increase 20% or more for Floridians, who are also likely to face an extra levy to cover a big shortfall in the state-run insurance fund.

With predictions of a worse hurricane season than normal this year, one would think the 68m people living in high-risk regions had learned their lesson. Despite the widespread flooding caused by such storms and though standard home policies do not cover flood damage, only about one-quarter of homeowners in risky areas have purchased flood insurance under a special scheme set up by the federal government. Given the thousands of people flocking to America's sunbelt, private insurers are likely to face more claims, and so come under growing pressure to price policies more accurately to reflect risks.

Meanwhile, the P&C sector faces another threat. By the end of June, the Treasury will report findings on the Terrorism Risk Insurance Act (TRIA), which provides federal reinsurance in the event of a terrorist attack. The TRIA is due to expire at year's end, but many insurers would like to see it extended, if not made permanent. There is opposition from those who insist this is a private-sector matter, but insurers retort that they would still incur big losses in the event of a terrorist attack. If the act lapses, the costs could overwhelm the industry. Many other developed countries offer a permanent government safety net to share the risk with private insurers. Insurers may be healthy today, but even the toughest among them shivers at the thought of attacks that could make hurricanes look like child's play.

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Canadian securities regulation

An end to the Wild West?

Jun 16th 2005 | OTTAWA
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The federal finance minister sees a chance to create a national watchdog

AT FIRST glance, there may seem little connection between the turmoil at the Alberta Securities Commission, one of 13 provincial and territorial agencies that regulate securities in Canada, and this week's renewed push by Ralph Goodale, the country's finance minister, to replace Canada's antiquated regulatory system with a single national body. Look again.

Stephen Sibold, who left the Alberta body last month when his five-year contract as chairman was not renewed, was the fiercest provincial opponent of Mr Goodale's plans. His position was undermined in January when unnamed employees at the Alberta commission complained to the provincial finance minister of lax enforcement and questionable management practices on his watch. These were serious charges, given that his agency regulates all publicly traded companies registered in the province, including most of Canada's top energy firms.

Mr Sibold called his accusers “depraved” and “malicious” and says he has been defamed. In March, an internal report rebutted the allegations of slack enforcement, although it acknowledged concerns about “human resource strategies”. But the damage was done. The commission now lacks a permanent chairman and its acting chairman is preoccupied by a fight with Alberta's auditor-general over access to commission files for an audit ordered by the provincial government.

No coincidence then that Mr Goodale chose this week to announce that his officials were talking to their provincial counterparts about revamping the outmoded regulatory system. The finance minister was careful to say he wants a single national regulator, which may or may not involve the federal government.

Under the current system, whose roots are about a century old, a firm selling shares across Canada must register with securities commissions in all ten provinces and three territories. Anyone wishing to give investment advice or sell mutual funds must do the same. Each jurisdiction has its forms to fill out and its fees to pay. Each has slightly different regulations. Little wonder that Canadian business is backing Mr Goodale's plan.

Most of the provinces have resisted change, despite a stern warning last winter by David Dodge, governor of the Bank of Canada, that foreigners considered the country a regulatory Wild West, with an inefficient system. There has been talk, but no action, on harmonising rules.

Lately, though, two things have changed. One is the temporary silencing of Alberta. The other is the federal government's clever linking of regulatory reform with the provinces' demand to review national fiscal arrangements. If the provinces want to discuss who gets what tax revenues, they must also talk about reform.

Ontario is the only province on Mr Goodale's side, not necessarily a plus in a federation characterised by interprovincial jealousy. The Ontario Securities Commission, Canada's largest, assigned the task of designing a national regulator to a panel it appointed earlier this month.

The Ontario body has repeatedly remarked on the absurdity of the current set-up. Of all the members of the International Organisation of Securities Commissions, including the other G7 countries, it says, only two lack a national or supranational regulator: Canada and Bosnia-Herzegovina. If that does not shame the provinces into reforming, nothing will.

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About sponsorship

Accounting standards

So far, so good

Jun 16th 2005
From The Economist print edition

But the real test for Europe's new accounting regime lies ahead

MANY things set the various countries of the European Union apart—language, culture and laws, to name a few. But since the start of this year the list has been one item shorter. From January 1st, Europe's 7,000 listed companies adopted international financial reporting standards (IFRS), replacing the mishmash of 25 local accounting regimes with one set of rules.

So far there have been no big blow-ups. The stockmarket, despite its skittishness when companies miss earnings targets by mere pennies, has taken revisions calmly. One reason is that many of the changes, long in the works, were expected. Many also believe that the revisions are mainly cosmetic, reflecting little about companies that was not already known.

Still, there have been some surprises. Lloyds TSB, a British bank, caused a ripple or two when it said late last month that the change to IFRS would cut this year's pre-tax profit by 8%, more than expected. A report in April by UBS, a Swiss bank, put the average absolute change in profits (before goodwill) of companies that had then announced results under IFRS at 12%. That hides a wide range. Deutsche Telekom's profit in 2004 was two-thirds lower under the new rules than under the old one, while Alcatel's and Telecom Italia's were more than twice as high.

Bigger revisions may lie ahead. The early reporters under the new rules have tended to be big, healthy companies. Smaller firms, with fewer resources to prepare for the change, may spring more surprises. More important, the real test is not the “one-time, two-dimensional restating of last year's information under IFRS” seen thus far, but the new system's “ongoing effect”, according to David Lindsell of Ernst & Young, an auditing firm. Under IFRS, the focus of accounts shifts from historic costs to “fair-value accounting”: the fluctuations in the value of everything from pension promises to property portfolios will be reflected regularly in profit statements. This seems sure to make profits much more volatile than in the past.

Most inconvenienced by this will be banks, insurers and other heavy users of financial instruments (derivatives, insurance contracts and the like) whose values change frequently, often by a lot. Worse, companies have had little time to apply the complex valuation rules, because these were not finalised until late last year, owing to a protracted tussle between standard-setters and European financial-industry regulators, the affected companies and politicians. Because controversy lingers, the rules may well change again.

Profits are not the only item affected. A study by Dresdner Kleinwort Wasserstein, an investment bank, found that under IFRS net debt is on average 16% higher than under local rules, with some companies hit much harder. Fiat, Italy's beleaguered carmaker, saw its debt double to about €16 billion ($19 billion). So far, no company has been downgraded for revising its debts. But Sue Harding of Standard & Poor's, a rating agency, notes that “it is still early days” and new disclosures could come to light that could impair a company's creditworthiness.

As with any rule, companies are likely to adapt their behaviour to get the best accounting treatment. This might be no bad thing: for example, IFRS rules requiring clearer disclosure of the state of company pension plans could lead to more scrutiny of how such plans are managed. Other possible changes in behaviour—such as reductions in foreign-exchange hedging—are more debatable.

One of the biggest complaints is that the new standards have led to insufficient consistency and comparability—contrary, you might think, to the whole point of IFRS. Now values must be found for things that often have no market price (such as employee stock options or most loans), so that estimates

matter far more than before. Moreover, companies have great flexibility in deciding how to apply IFRS. In aerospace, the leeway given to companies in accounting for financial instruments “seriously limit[s] the comparability” of BAE Systems and Rolls Royce, according to a UBS note this week. Dennis Jullens of the bank thinks that in some cases it would have been better to limit firms' choices.

To a degree, says Guy Weyns of Morgan Stanley, this flexibility is inevitable because IFRS aims to be “principles-based” rather than highly detailed and prescriptive, like American accounting rules. He adds that companies are much easier to compare than under the old hotch-potch. For all its flaws, the new rules—which 90 countries have adopted or will adopt—are a big step towards global accounting standards. American and international standard-setters have made steady progress over many years to close the gap between America's rules and the rest.

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Economics focus

To give or forgive

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The G8 wants to wipe clean the debts of impoverished nations. Erasing poverty will be harder

MISERS may be disliked, but usurers are despised. This may explain the remarkable success of the long-running campaign by churches, charities and celebrities to have the debts of poverty-stricken countries written off. Even when aid budgets were especially tight—roughly speaking, from 1993 to 2001—the campaign shamed the governments of the G7 rich nations into cancelling much of their bilateral debt. Reluctant to give money to poor countries, rich countries' governments became equally chary of collecting debts from them.

On June 11th, the debt-relief campaign won another triumph. At a meeting in London hosted by Gordon Brown, Britain's chancellor of the exchequer and a strong advocate of debt relief, the finance ministers of the G8 (the G7 plus Russia) agreed to cancel all the debts that 18 heavily indebted poor countries owe to three multilateral lenders, the World Bank, the International Monetary Fund (IMF) and the African Development Bank (AfDB).

The beneficiaries are Guyana, Honduras, Nicaragua, Bolivia and 14 African countries. The debts in question have a face value of about $40 billion, on which an annual average of $1 billion-1.5 billion is paid in debt service. Nine other countries may benefit within a few years, and a further 11 would be eligible if their governments were not so inept and corrupt.

To understand how the London agreement works, you have to follow the money. Next year, for example, Rwanda was due to pay at least $4.5m in debt service to the Bank and the AfDB and a further $2.9m to the IMF. Assuming the G8 proposal is passed and implemented promptly, Rwanda will no longer need to do that. However, the loans or grants it receives from the Bank and the AfDB in 2006 will be “adjusted” (ie, cut) by $4.5m, the same amount it saves on servicing its debts to them. So in the first instance it will have just $2.9m extra—the money it would have paid to the IMF—to spend on health care, education and so forth.

Some—notably, America—would have been happy to leave it at that. But at Britain's insistence, the new agreement goes further. The G8 acknowledges that, by freeing Rwanda and its sort of their debts, it is depriving the Bank, Fund and AfDB of loan revenue. The IMF will have to take the loss on the chin. But the Bank and the AfDB will be reimbursed. The two can then pass this new money on to poor countries, as they see fit. Rwanda might well see some of this extra money, but it need not.

There is one last twist in the money trail: from where will the G8 countries get the money to refund the Bank and the AfDB? They could raise it from their taxpayers. They could divert it from funds already allocated to their own aid budgets. Or they could deduct it from money they might otherwise have given the Bank and the AfDB. Their donations to the Bank have already been settled for the next three years, so any such diversion will be easy to spot in the short term. But in the future, there will be no way to know how much the G8 would have given the Bank in the absence of 100% debt relief. So one cannot know whether the money promised in London will come in addition to, or instead of, the money they would have given anyway.

Give and take

There is thus less to the London agreement than first meets the eye. Rich countries are often accused of giving with one hand and taking with the other. That said, in general, what donors take in debt repayments, they give back several times over in aid. Mozambique, for example, paid $71.8m on its

debts in 2003. But the aid it received from all donors, multilateral and bilateral, amounted to about 14 times that figure. Admittedly, that includes the value of debt relief itself, and Mozambique's experience is extreme. But on average, reports the Bank, in the 1990s the heavily indebted poor countries received about twice as much in aid as they paid in debt service.

In a recent article*, Raghuram Rajan, chief economist at the IMF, teases out the implications of these two-way flows. Suppose a country pays $100m a year in debt service, but receives $200m in aid. How does its situation differ from a debt-free country that receives $100m in aid a year? The annual net inflow of money is the same; only the stock of liabilities differs.

Under certain circumstances, Mr Rajan notes, this stock of debts can cast a shadow over a country's prospects. It may deter private investment, because investors fear the government will overtax their profits to repay its creditors. A lack of investment will stunt growth, further diminishing the country's ability to service its debt. Debt relief is then in the interest of creditors and debtors alike. It will increase the real value of the creditors' claims, because it restores the confidence of investors and thus the economy's ability to meet its obligations.

However, Mr Rajan doubts the relevance of this idea to the beneficiaries of the G8's proposal. There are many reasons why private investors might be deterred from an impoverished African country: corruption, insecure property rights, fragmented markets, lousy infrastructure. Debt is the least of them.

Mr Brown sees debt relief as but one step in increasing the resources that are made available to fight poverty. Aid budgets have already been rising; and Mr Brown and Britain's prime minister, Tony Blair, are pushing for another big increase in aid at the Gleneagles G8 summit in July. But Mr Brown's American counterpart, John Snow, sees debt relief as the last turn in a long-running “cycle of lend and forgive”. Efforts to ease Africa's official debts date back at least as far as 1987. Since then, Mr Snow points out, donors have repeatedly lent poor countries fresh money to help repay old loans gone sour. This month's deal should go some way to achieving Mr Snow's objective. But it will do little by itself to secure Mr Brown's.

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* “Debt Relief and Growth”. *Finance and Development*, June 2005.

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Brain science

Helpful junk

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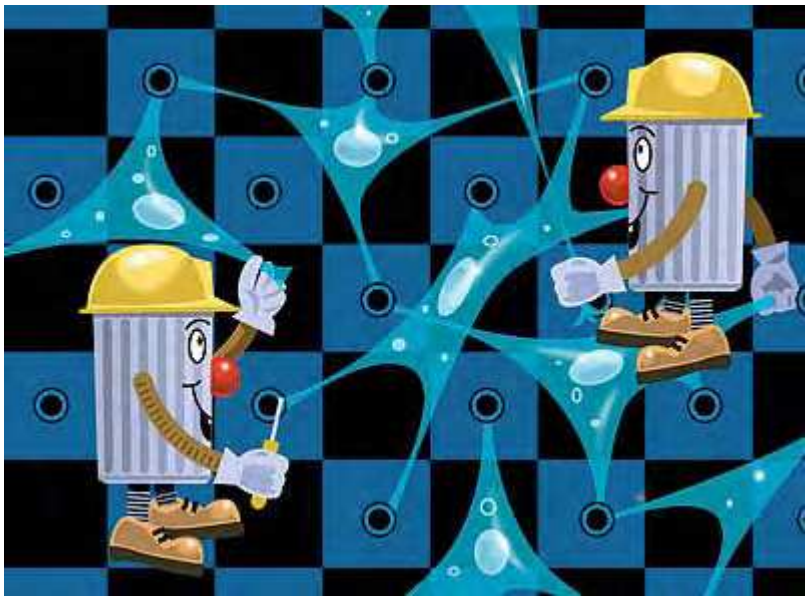

Brain development may be influenced by genetic parasites

THE brain is the most complicated object known. How it gets that complicated is, however, almost completely unknown. But part of the answer may turn out to be junk—at least that is the conclusion of a study led by Fred Gage of the Salk Institute in La Jolla, California, which has just been published in *Nature*.

One of the puzzling features of the human genome is that although genes are numerous they actually form less than 5% of the DNA in a cell nucleus. The rest was thus, rather cavalierly, dubbed “junk DNA” by those who discovered it. Gradually, a role for some of this junk has emerged. In particular, parts of it regulate the activity of genes, and thus which proteins are produced and in what quantities. That has implications for what a cell does—or, to put it another way, what type of cell it is. One of the most puzzling sorts of junk, though, is something known as a LINE-1 retrotransposon. This is junk that won't stay in one place.

Retrotransposons are sometimes known as “jumping genes”. They pop from chromosome to chromosome with gay abandon. The assumption has been that they are genetic parasites. They resemble retroviruses, which certainly are parasites (HIV, the cause of AIDS, is a retrovirus). And the effect of a string of irrelevant LINE-1 DNA popping into the middle of a functional gene is indeed traumatic. The gene in question stops working.

The parasite hypothesis is supported by the fact that although bits of DNA that look as if they have once been part of a LINE-1 element make up 20% of the human genome (ie, they are more than four times as abundant as real genes), only 100 retrotransposons are actually able to leap around, and only ten of those leap often. By and large, the parasites have been disabled, suggesting they are such bad news that evolution has eliminated them. Dr Gage and his colleagues, however, suspect that at least some of those that have not been disabled have been allowed to live on for a purpose. Instead of being destroyed, they have been subverted—and what they have been subverted to do is to create complexity in the brain.

Light fantastic

The researchers were led to this idea when they scanned the stem-cell precursors of nerve cells with a device called a gene chip. This detects the activity of genes by measuring the presence of the molecular messengers they send into the cell to do their bidding. To their surprise, the researchers discovered a lot of LINE-1 messengers, suggesting that retrotransposons are active in these precursor cells.

To find out what was going on, Dr Gage and his colleagues built a piece of DNA that included a human LINE-1 retrotransposon; a gene for a molecule called green fluorescent protein (GFP); a genetic switch to turn the whole lot on; and a special sequence of DNA that keeps the switch in the “off” position unless the retrotransposon jumps from one place to another. The result of all this genetic engineering was a system that produces light in cells in which a retrotransposon has jumped. And GFP glows green, as its name suggests, so such cells are easy to spot.

The researchers spliced their creation into the DNA of nerve-cell precursor cells from rats (which they then grew as laboratory cultures). They also spliced it into the DNA of a line of mice, so that it was present in every cell in the mice's bodies.

Nerve-cell precursors can turn into two types of brain cell besides nerve cells. These other two types have supporting, rather than starring roles in the brain, and cannot transmit nerve impulses. The rat-cell work showed that LINE-1 jumping happens only in precursors that turn into nerve cells, and that it seems to be regulated by a protein called Sox2 that is already known to play a crucial role in the formation of nerve cells. The mouse work showed that LINE-1 was not jumping in any other parts of the body (except, oddly, the sex cells—a result that had been seen before). That suggests it is happening in the brain for a purpose.

The mouse work also showed that the retrotransposons were jumping mainly into genes that are active while precursor cells are changing into their destined cell types. The team identified a dozen and a half such genes that were affected by LINE-1, and followed up one of them, *PSD-93*, in detail. *PSD-93* makes a protein found in the places where nerve cells touch each other and pass their signals on. When LINE-1 jumped to a location in the genome near *PSD-93* it increased production of the protein. That increase, at least in cell cultures, made it likelier that a developing precursor cell would turn into a nerve cell.

So much is observation. This is where the speculation comes in. Brain formation is an incredibly wasteful process. About half of the nerve cells created in a developing brain have died by the time that brain has formed. Many researchers think that which cells live and which die is decided by a process similar to natural selection. Cells with the right properties in the right places flourish; those without wither. But natural selection requires random variation to generate the various properties.

Retrotransposons could provide that variation, by affecting gene expression at random, depending on where they pitch up. Changing the quantities of proteins such as the one made by *PSD-93* would probably change the nature of the affected cell quite radically, and might even be responsible for generating the different types of nerve cell that are known to exist. Certainly, the brain has many more different types of cell in it than any other organ.

A similar idea about generating variation has been proposed in the past, to explain the activity of LINE-1 elements in sex cells. This, the theory goes, would bolster variety in an individual's offspring above and beyond the variation already provided by sexual reproduction. That is an interesting idea. But the thought that the complexity of the mammalian brain—and the existence of human intelligence—depends on variety induced by a tamed genetic parasite is truly audacious. Whether it is true remains to be seen.

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Mobile phones

I'm on the train

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Are mobiles phones on trains dangerous or not?

COMMUTER trains are often stuffy and crowded, and they frequently fail to run on time. As if that were not bad enough, Tsuyoshi Hondou, a physicist at Tohoku University in Japan, published a paper in 2002 that gave commuters yet another reason to feel uncomfortable. Dr Hondou examined mobile-phone usage in enclosed spaces such as railway carriages, buses and lifts, all of which are, in essence, metal boxes. His model predicted that a large number of passengers crowded together, all blathering, sending text messages, or browsing the web on their phones, could produce levels of electromagnetic radiation that exceed international safety standards. That is because the radio waves produced by each phone are reflected off the metal walls of the carriage, bus or lift. Enough radiation escapes to allow the phone to communicate with the network, but the rest bathes the inside of the carriage with bouncing microwaves.

This sounds worrying. But maybe it isn't after all. In a paper published recently in *Applied Physics Letters*, Jaime Ferrer and Lucas Fernández-Seivane from the University of Oviedo in Spain—along with colleagues from the Polytechnic University of Madrid and Telefónica Móviles, a Spanish mobile operator—dispute Dr Hondou's findings. They conclude that the level of radiation is safe after all.

The key addition to the new research is the effect of the passengers themselves. While each phone produces radiation that bounces around the car, the passengers absorb some of it, which has the effect of reducing the overall intensity, just as the presence of an audience changes the acoustics of a concert hall, making it less reverberant. Dr Hondou's model, in short, was valid only in the case of a single passenger sitting in an empty carriage with an active mobile phone on every seat.

While Dr Hondou acknowledged this in his original paper, he did not specifically calculate the effect that leaving out the other passengers would have on the radiation level. As a result, say the authors of the new paper, he significantly overestimated the level of electromagnetic radiation. When one is sitting on a train, Dr Ferrer and his colleagues found, the most important sources of radiation are one's own phone, and those of one's immediate neighbours. The radiation from these sources far exceeds that from other phones or from waves bouncing around the carriage. And all these sources together produce a level of radiation within the bounds defined by the ICNIRP, the international body that regulates such matters.

People concerned about the effects of mobile-phone radiation are unlikely to take much comfort from Dr Ferrer's results. They worry that even small amounts of microwave radiation—within the ICNIRP's limits—may have adverse health effects. The evidence so far is ambiguous, inconsistent and sparse. Indeed, Dr Ferrer says he was surprised at how little research has been done in this area.

Yet both Dr Hondou's results and Dr Ferrer's are based on mathematical models, not physical measurements. Their models make assumptions about the physical properties of train carriages and their passengers, and both assume that the radiation is uniformly distributed rather than clumped into “hot spots”. But if the debate about the safety of mobile phones is to be resolved, there must be less reliance on models and anecdotes, and more emphasis on hard experimental data.

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About sponsorship

Space propulsion

Sail of the century

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One small step into orbit may be one giant leap for interplanetary travel

Rick Sternbach, The Planetary Society

ON JUNE 21st, a Russian nuclear submarine is due to launch an intercontinental ballistic missile (ICBM) from beneath the surface of the Barents Sea in the Arctic Ocean. Fortunately, this will not be the opening volley in a global thermonuclear war. Rather, it is intended to open up a new age of space exploration.

The ICBM's payload is *Cosmos 1*, an experimental spacecraft being launched by the Planetary Society (a space-advocacy group founded in 1980), in conjunction with NPO Lavochkin (a Russian firm which built the craft) and the Makeev Rocket Design Bureau (which modified the ICBM). If the mission, which will cost $4m and has been paid for entirely by private subscription, is successful, *Cosmos 1* will become the first craft powered by solar-sail technology to orbit the Earth.

Solar sails rely on the fact that particles of light, or photons, that strike a surface give it a tiny push. Ideally, such sails should be as big as possible, to maximise the amount of sunlight collected, and as reflective as possible, because a photon bouncing off a perfectly reflective sail produces twice as much thrust as one absorbed by a non-reflective sail. Even so, the thrust generated is tiny: a sail with an area of one square kilometre would feel the same force that a kilogram weight exerts on a table on Earth. But there is no air resistance in the vacuum of space, and the sun shines continuously. Slowly but surely, the light-propelled tortoise outruns the rocket-driven hare, reaching 200,000kph after three years of acceleration.

Solar sails would thus be especially useful for journeys to distant planets or vastly more distant stars, as they do not need to carry any fuel with them. But while they have lived in the imaginations of scientists and science-fiction writers for over a century, their track record in real life has been limited. The Japanese Aerospace Exploration Agency has tested the unfurling of solar sails on sub-orbital rockets, but no one has put solar sails into orbit. *Cosmos 1* should change that and, if it works, it will prove the feasibility of the technology for future missions.

Eight triangular sails arranged like the petals of a flower will propel the craft. Each of the sails is 15 metres long, and in total they span 600 square metres—roughly the size of the penalty area on a football pitch. During launch, the sails will be rolled up like so many sleeping bags. Once the ground crew has decided that the craft is in a stable orbit, though, a series of tubular “masts” will be inflated that will unfurl the sails as they expand.

Solar sails require special materials if they are to reflect sunlight efficiently while weighing as little as possible. They must also be able to fold up easily into a small space. *Cosmos 1*'s sails are made from plastic sheets just five microns (millionths of a metre) thick. That is about a quarter of the thickness of a plastic dustbin liner. The plastic in question, Mylar, is coated with aluminium to make it reflective. Mylar is perhaps more familiar from its use in helium-filled party balloons.

If all goes as planned, the spacecraft will go into an orbit that flies over the Earth's poles. Four days later, the sails will be deployed. Once this has happened, the team will monitor *Cosmos 1*'s altitude. The sails are able to swivel slightly, and the ground crew can tilt them individually in order to catch the most sunlight. The resulting increase in the altitude of the orbit will indicate that the sails are indeed feeling the sun's push.

Provided all this works well, the team will then try one last experiment. In order to use solar sails to travel to the outer planets, where the sun's light is much dimmer than it is near Earth, it might be helpful to augment sunlight with lasers or microwaves beamed from Earth. To test this idea, Microwave Sciences, a company based in California, plans to beam a 450-kilowatt burst of microwaves from an antenna in the Mojave Desert towards *Cosmos 1* to see if it can put some extra wind into its sails. If it can, the first vessels to cross between the stars may be sailing ships.

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About sponsorship

Aviation

Haute couture

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A new aeroplane has been designed entirely in virtual reality

This one goes there, that one goes there

THIS week, on a Paris runway, the latest designs were on display—of aircraft, that is, rather than clothes. Sleek models, such as Gulfstream's G450 business jet, jostled for attention alongside the latest in plus-size aviation fashion, the curvaceous Airbus A380. But when it comes to attention to detail, this year's most exceptional debut was the Falcon 7X, which made its first public flight. Designed and built by Dassault, a French aviation company based in Paris, the 7X lays claim to being the first fly-by-wire business jet, as well as the first aircraft to be designed entirely in a virtual environment. This latter claim bears some dissection as it hardly comes as a surprise to learn that a new aeroplane was developed using computer-aided design, or that its various possible wing shapes had been simulated to predict airflow and performance before the craft had so much as a sniff at a wind-tunnel test.

The makers of the 7X, however, say that its digital design process went beyond anything that has been done before. Every aspect of the aircraft was modelled in three dimensions, as you would expect, but everything from construction to refuelling and maintenance was also included in the simulation. A single database was used to define the aircraft's design, including all 40,000 of its parts and 200,000 fasteners. This database was shared between workers at the 30 or so firms which contributed different parts of the plane. Before a single piece of metal was cut, everyone involved, from hydraulics specialists to electrical engineers, could walk around the plane in virtual reality and iron out conflicts over what went where. The design extended to the robots that would create the tools to fit the parts of the plane together, and to the aeroplane's maintenance in later years. Can a mechanic actually reach a particular component to replace it, and is it physically possible to turn the spanner? Nothing was left to chance.

As a result, the first plane to be constructed was perfect: there was no physical prototype. All the parts were manufactured and put together, and then the plane was flown—its first, private flight took place just over a month ago. This also means that the first plane off the production line will be identical to the 100th. In aviation, the first few dozen aircraft of a particular design are normally tweaked as unanticipated problems arise. In the past, for example, wires would turn out not to be in quite the right place and would have to be moved, says Olivier Villa of Dassault. Although the design phase took longer than expected, Dassault found that manufacturing time and tool costs were cut in half. These costs can account for 25% of the overall cost of a new aircraft, says Mr Villa.

Another benefit is that Dassault can produce customised versions of the 7X in three months rather than six. Snazzy software will let prospective buyers of the eight-passenger corporate jet walk around their

chosen design before they buy. The 7X is already selling well, even though it costs an eye-watering $40m and is still over a year away from being certified to fly. Virtual reality may be removing the art from aeroplane design, but Jean-Paul Gaultier would surely be impressed.

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Polio

Bracing stuff

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Still Pictures

It has been 50 years since America and Europe were hit by a polio epidemic. But in the third world the disease has never gone away. Four books look at a cruel legacy

FOR most westerners under the age of 50, polio is a curiosity; as much a 20th-century relic as Bakelite or the zeppelin. But for many people in poor places, the disease is alive and kicking—unlike its victims. To see polio today, you need to step deep into the developing world. To the streets of Nairobi, where gnarled youngsters shunt tooting drivers towards a rare empty parking space in return for a few coins. Or to Delhi, where the flies are thick, and poverty grinds men down as unremittingly as it does the women who sit in doorways crushing spices. In both cities, children hobble all day on old hand-me-down crutches, dragging their withered limbs behind them.

In the 21st century, polio is by and large a disease of poverty. It was not always so. The polio epidemics which swept over North America and western Europe between the late 19th and mid-20th centuries took their toll on the middle and upper classes as well. The virus that causes polio spreads through what is politely known as the “faecal-oral route”. In earlier times, infants would pick up the germ when they were still young enough to be protected by their mother's antibodies, buying time for them to develop their own immune response. But the drive towards hygiene and domestic cleanliness which characterised 20th-century western societies meant that children lost that critical early exposure. So when polio came to town, everyone was vulnerable.

Of course not everyone succumbed. Most of those infected had no symptoms at all, but 1-2% went on to develop paralysis. Some victims recovered with surgery and rehabilitation; many were permanently handicapped and some died. Polio is by no means history's deadliest disease, but it is one of its most traumatic because of the trail of living victims—mostly children—who are left in its wake.

Polio: An American Story—The Crusade That Mobilized the Nation Against the 20th Century's Most Feared Disease
By David M. Oshinsky

Oxford University Press; 342 pages; $30 and £18.99

Buy it at
Amazon.com
Amazon.co.uk

Polio and its Aftermath: The Paralysis of Culture
By Marc Shell

As David Oshinsky argues in his excellent book, “Polio: An American Story”, the disease was regarded, much like communism, as an assault on the very heart of American society. In this particular war, however, America mobilised early on thanks to the efforts of the National Foundation for Infantile Paralysis (as polio was sometimes called), which was set up in 1938. The foundation pioneered what has become standard practice for medical charities—celebrity endorsements (Eddie Cantor, a vaudeville star, coined the foundation's most-famous slogan, “March of Dimes”), volunteer fundraising and large-scale financing of medical research.

Mr Oshinsky does a good job of recounting famous tales from the war on polio, among them Franklin Roosevelt's personal and public battles with the disease, and the long-running skirmishes between Jonas Salk and Albert Sabin, the scientific rivals who independently developed the so-called “killed” and “live” polio vaccines which became the mainstay of prevention from 1955 onwards. But the book also unearths some of the fascinating forgotten stories, like that of Fred Snite, nicknamed “Crazy Foreign Devil”, who contracted polio in China in 1936 and travelled 900 miles across country, and back home to Chicago, in a whole-body, coffin-like respirator known as an iron lung; or the particular difficulties encountered by black polio patients in an age of racial segregation; or the saga of Sister Elizabeth Kenny, an indomitable Australian nurse, who outraged America's medical establishment with her smelly, scratchy (though effective) treatment of packing patients in hot wet wool to loosen their immobilised muscles, at a time when many doctors firmly believed in strapping patients in splints to prevent deformities.

Marc Shell's book, “Polio and its Aftermath”, is full of equally obscure, but far less illuminating, anecdotes. Mr Shell developed polio in 1950s Quebec. Alas, his own interesting story and that of other famous “polios” (as its victims are known), among them J.G. Farrell and Frida Kahlo, are lost in a mess of literary analysis. The result is as wet and woolly as one of Sister Kenny's treatments.

Many of the same sources in Mr Shell's book are used to far greater effect in “Living with Polio”. Daniel Wilson, also a polio victim, pieces together the experiences of 150 patients into a moving picture of the disease, from early symptoms to the alarming emergence of post-polio syndrome, a sort of neuronal exhaustion which sets in decades after the original episode. The pain, fear, guilt, isolation and tenacity of polio's victims, and their families, are powerfully described and are in many ways reminiscent of the latest greatest plague, AIDS. Like today's AIDS patients, polio survivors had a significant impact on attitudes towards illness; as Mr Wilson explains, the determination of polio survivors helped break down barriers for the handicapped, spurring “a civil rights movement to free people with disabilities from cultural assumptions, from medical control...and to make their own decisions about how they would lead their lives.”

America was hammered by polio, with more than 415,000 cases between 1937 and 1955, but it was not alone in its suffering. Patrick Cockburn's memoir, “The Broken Boy”, tells of his own experience of being struck down with polio in rural Ireland. His extraordinary parents were used to living dangerously—his father, Claud Cockburn, was a famous journalist whom MI5 was convinced was a “formidable factor on the side of Communism”—but they little imagined the risks they were running in moving their young sons into the eye of a polio storm in Cork in 1956. Both the author and his brother came down with the disease, the former left paralysed and unable to walk without crutches. He eventually overcame his disability to become a journalist, and his experiences in war-torn Afghanistan and Iraq weave in and out of the book; more on how Mr Cockburn's own fight against polio shaped his views of such crippled countries would have been welcome.

As for polio itself, the battle goes on. Eighteen years after the World Health Organisation launched a global drive to wipe out the disease, the annual number of known cases has fallen from 300,000 to just over 380 so far this year. The virus still lurks in places where vaccination fails to reach all those at risk—India, Pakistan, Afghanistan and Egypt for example. The most recent outbreak in Nigeria has spread to 16 countries, from West Africa to Indonesia. It will be some years yet before polio can be consigned to the history books.

Harvard University Press; 324 pages; $35 and £22.95

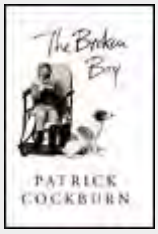
Buy it at
Amazon.com
Amazon.co.uk

Living with Polio: The Epidemic and its Survivors
By Daniel J. Wilson

University of Chicago Press; 300 pages; $29 and £20.50

Buy it at
Amazon.com
Amazon.co.uk

The Broken Boy
By Patrick Cockburn



Jonathan Cape; 312 pages; £15.99

Buy it at
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Polio: An American Story—The Crusade That Mobilized the Nation Against the 20th Century's Most Feared Disease.
By David M. Oshinsky.
Oxford University Press; 342 pages; $30 and £18.99

Polio and its Aftermath: The Paralysis of Culture.
By Marc Shell.
Harvard University Press; 324 pages; $35 and £22.95

Living with Polio: The Epidemic and its Survivors.
By Daniel J. Wilson.
University of Chicago Press; 300 pages; $29 and £20.50

The Broken Boy.
By Patrick Cockburn.
Jonathan Cape; 312 pages; £15.99

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About sponsorship

Reflections on India

Sen's sensibility

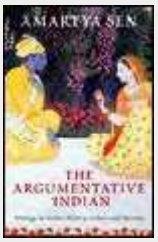
Jun 16th 2005 | DELHI
From The Economist print edition

LATE last year, when Amartya Sen gave a lecture in his homeland's capital, Delhi, there was standing room only. Among those who arrived too late to gain entry were top industrialists, senior diplomats and the prime minister's press secretary. That such bigwigs were excluded is testimony to India's democratic strengths. That they should come at all captures much else that is admirable about the country: its pride in the successes of its emigrants, its love of intellectual stimulation and debate, and its special respect for Mr Sen.

The winner of the 1998 Nobel prize in economics is a star in India, partly because he is admired both by economic liberals and by those who worry that globalisation will destroy India. And he deserves the recognition, as this book shows. A collection of essays, lectures and articles written over the past decade, “The Argumentative Indian” reveals the scope of Mr Sen's interests. These extend far beyond the work that won him the Nobel, notably his investigation into the causes of famines, and his elaboration of social-choice theory. The 16 chapters range from an appreciation of Rabindranath Tagore, a great poet of Mr Sen's native Bengal, to an examination of the historic intellectual links between India and China, to a discussion of India's wealth of sophisticated calendars.

Mr Sen has done more than most authors of such anthologies to turn this into a coherent book rather than a random miscellany. It does not avoid all repetition, overlap and incongruity. But it does offer a variety of perspectives that illuminate a central theme: that India has a long and noble argumentative tradition, and that this is worth celebrating. Heterodoxy is, he claims, its natural state.

The Argumentative Indian: Writings on Indian History, Culture and Identity
By Amartya Sen



Penguin/Allen Lane; 409 pages; £25. To be published in America by Farrar, Straus and Giroux in October

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AP

More conscience than eminence

This seems obvious, as do his memorable opening sentences: “Prolixity is not alien to us in India. We are able to talk at some length.” But the squabbling is often seen as a drawback. India's inability to shut up slows decision-making and seems to condemn the country to a slower march out of poverty than the rush under way in neighbouring China. However, Mr Sen shows that the argumentative gene is not just a part of India's make-up that cannot be wished away. It is an essential part of its survival—and an advantage.

Politically, this places Mr Sen on the right side of the great debates both within India and between Asia and the West. In India, he rejects the identification of Indianness with Hinduism, the religion of most of its people, and the implications that that carries for the country's Muslim, Christian and other minorities. Instead he champions Mr Tagore's view that “the idea of India” itself militates “against the intense consciousness of the separateness of one's own people from others”. Similarly, an essay inspired by Satyajit Ray, a film- maker from Bengal, is an elegant demolition of arguments that authoritarian rule is somehow rooted in Asian values.

The essay on Mr Ray also includes a fine defence of foreign influence, so feared by many in India as an insidious assault on its own traditions. Mr Sen points out how “Pather Panchali”, the film that made Mr Ray's name abroad, was directly influenced by Vittorio De Sica's “The Bicycle Thief”, a 1948 Italian masterpiece. Yet the Italian influence did not make it “anything other than an Indian film; it simply helped it to become a *great* Indian film”. The same observation holds for Mr Sen's own involvement with his chosen discipline.

The Argumentative Indian: Writings onIndian History, Culture and Identity.
ByAmartya Sen.
Penguin/Allen Lane; 409 pages; £25. To be published in America by Farrar, Straus and Giroux in October

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About sponsorship

Chinese cinema

Generation five

Jun 16th 2005
From The Economist print edition

IN 1978, something remarkable happened in Chinese cinema: the Beijing Film Academy, China's national film school, reopened for the first time after it was closed during the Cultural Revolution. Four years later, in 1982, 153 students graduated and were labelled the “fifth generation” of film-makers to emerge since the birth of Chinese cinema. They were the first to see what the rest of the film world was doing. The innovations of Michelangelo Antonioni and Akira Kurosawa encouraged these Chinese fledglings to experiment in ways long absent from the stolid Chinese movies favoured by Madame Mao.

Paul Clark, who teaches Chinese at the University of Auckland, has written a comprehensive and perceptive account of the films that emerged from this cradle. He focuses on ten directors, including Chen Kaige, who kick-started the movement with “Yellow Earth” (1984), and Zhang Yimou, the most successful of the bunch, whose “Red Sorghum” (1987) won the top prize at the Berlin film festival, alerting the world to this new wave from China.

Reinventing China: A Generation and Its Films
By Paul Clark

Chinese University Press; 257 pages; $39

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Amazon.com
Amazon.co.uk

Many of the class of 1982, who had once enjoyed a privileged background by Chinese standards, had been sent during the Cultural Revolution to the countryside, where they suffered many indignities. Mr Chen was required to denounce his father. Mr Zhang, whose first love was photography, sold blood to buy a camera and was forced to use toilet water to develop film.

Their enthusiasm for the Communist Party, when they came to make their first films, was understandably muted. But overt criticism was still taboo, so the fifth generation made extensive use of allegory. Is the brutal Japanese army in “Red Sorghum” to be read as a metaphor for something more recent? Foreign critics have speculated on this, but Mr Zhang has always kept scrupulously mum. “The Big Parade” (1986), a story of military training, which Mr Chen was ordered to end with a celebration of the state 35th anniversary parade in Tiananmen Square, can in fact be read as a critique of conformism.

The fifth generation baffled the authorities, who welcomed the kudos it was earning abroad but felt instinctively that wool was being pulled over their eyes. Mutual suspicions abounded. “Dove Tree”, a humanist picture set during the Sino-Vietnamese border dispute of 1979, was suppressed for showing the enemy in a sympathetic light. Tian Zhuangzhuang, who in “The Blue Kite” was able to complete an exposé of the Cultural Revolution by having the film developed in Japan, once said that he made films for the 21st century. Deng Xiaoping, no less, promptly invited him to pick up his paycheck in the 21st century, too.

What eventually choked the fifth generation, however, was not official disapproval, nor even the fact that films about the Cultural Revolution came to seem increasingly irrelevant to the younger generation, but the economic changes that were taking place within China itself. A widening range of leisure activities led to a precipitous fall in cinema admissions and pressure to amend the content of Chinese movies to mimic and compete with Hollywood imports, which were few in number but overwhelmingly popular.

Not many of the original fifth-generation graduates are making similar films today. Some have retreated into action thrillers, others, like Mr Chen and Mr Zhang, into sumptuously filmed costume dramas, where the production values sometimes outclass the scripts.

All, however, is not lost. Take Li Shaohong, whom the author, in a rare slip, calls Li Shaobei. Ms Li made her mark in 1990 with “Bloody Morning”, a striking adaptation of “Chronicle of a Death Foretold”

translated to a Chinese setting. More recently she has successfully connected with the new youth culture with her stylish film “Baober in Love”, while Gu Changwei, who shot “Red Sorghum”, triumphantly evoked past glories with his directorial debut, “Peacock”.

Reinventing China: A Generation and Its Films.
By Paul Clark.
Chinese University Press; 257 pages; $39

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18th-century Britain

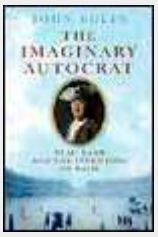
Pillar of the city

Jun 16th 2005
From The Economist print edition

AT THE beginning of the 18th century the city of Bath, in the west of England, could not be said to be doing very well for itself. Its trading significance had dwindled, its celebrated Roman baths were crumbling and, most awkward of all, a whiff of the unfashionable and treasonable Jacobite cause still hung over it. Anyone with something to lose was careful to take their gout or dizzy spells to Epsom or Tunbridge Wells instead.

Move on 15 years and the situation could not be more different. Britain was settling into a century of political stability and conspicuous consumption, and Bath found itself at the heart of a new culture of pleasure and politeness. Hotels were packed with smart people, and the city was bustling with slick doctors and their slightly ailing yet mostly cheerful patients. Presiding over this miraculous transformation was Richard Nash, the city's “Master of Ceremonies”, who continued, until the end of his long life in 1761, to ensure that the place ran as smooth as silk.

The Imaginary Autocrat: Beau Nash and the Invention of Bath
By John Eglin



Profile Books; 292 pages; $35 and £20

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Amazon.co.uk

John Eglin, a professor of history at the University of Montana, is not interested in excavating the meagre sources to pad out a sketch that has come down to us mostly via Oliver Goldsmith's cut-and-paste biography written 18 months after Nash died. Nor does he wish to offer an architectural or cultural history of 18th-century Britain's capital of fun. Rather, he sets out to explore the ways in which the personal mythology of Beau Nash as a benign tyrant ruling over Britain's smartest city insinuated itself into narratives about Bath's supremacy to the point where one came to stand for the other.

The result is a fascinating demonstration of the subtlety that a new generation of historians is bringing to the period. Mr Eglin is acutely alive to the way in which the received view of Bath, as a serene and homogenous Georgian polis, works to hide the fact that for most of Nash's time the place was a construction site, squabbled over by a set of bad-tempered competing interests: builders, architects and the city corporation itself. Careful archival work also reveals that Nash was in fact far less central to many of the developments that went to make up the Bath of popular imagination. He had nothing to do with its architectural evolution, for instance, and his tenure as master of ceremonies was never ratified by the corporation, by the company (the seasonal visitors) or any authority other than his own.

It was in fact his “assurance”, a particularly 18th-century gloss on what we might call swagger or cheek, that allowed Nash, the son of an obscure Welsh merchant, to strut around the place, being rude to duchesses and sending young gentlemen home to change, brokering marriages and seeing off fortune hunters. As Mr Eglin convincingly argues, it was Nash's early experience as an outsider, both at Oxford and later briefly in the Inns of Court in London, that made him so alert to the way in which the new commodity culture worked and how it might be manipulated to his advantage (although, sadly, he ended worn out at 80, conspicuously lacking in commodities of even the most everyday kind, and buried quite possibly in a pauper's grave). The result is a book that bears important witness to the way in which narrative history with its stale linear plots is in the process of being broken down and remade in richer, more variegated ways.

The Imaginary Autocrat: Beau Nash and the Invention of Bath.
By John Eglin.
Profile Books; 292 pages; $35 and £20

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Democracy

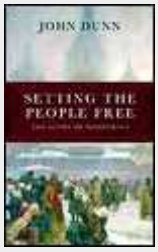
Perks of persuasion

Jun 16th 2005
From The Economist print edition

ALMOST all of us are for democracy now. But what is it? We tend to know until we ask. The news adds to our puzzlement. A thoroughly democratic referendum in France as good as kills constitutional changes which, defenders say, would have made the European Union more democratic. China's post-Maoist leaders promise riches first and, maybe, democracy later. Iraqi drafters of a democratic constitution to replace one-party tyranny disagree over the legitimate reach of strict religious law. Each item touches democracy's core. At what political level does it work best? Is it tradable for prosperity or stability? How far may majorities compel minorities in its name? None of these questions is academic.

Answering any of them in fewer than 250 pages would be a feat. John Dunn, a professor of political theory at Cambridge University, tackles them and more in this rich and subtle essay. He describes how government by the people began and what it has become. He blends history and ideas, bringing alive contemporary arguments for and against democracy, particularly in the American and French revolutions. It is a masterly performance.

Setting the People Free: The Story of Democracy
By John Dunn



Atlantic Books; 246 pages; £16.99. To be published in America by Grove Atlantic in January 2006

Buy it at
Amazon.co.uk

He starts in fifth-century Athens, where the term “democracy” came from. Its intricate system of self-rule by an active citizenry remains an archetype of the direct or participatory sort. After excluding a quarter of a million women, children, foreigners and slaves, Athenian citizens numbered only 30,000-40,000. That lucky minority engaged, or had a right to engage, in government more fully than people virtually anywhere since.

Many more people have a say in how they are ruled today, but there is less choice. Voters pick among small groups of politicians competing for the right to rule pretty much as they choose within the law until dismissed at the polls. Virtually none of the theorists of representative democracy—Madison on the right, for example, or Robespierre on the left—thought anything else remotely practical. So different are the direct and representative sorts of democracy that Mr Dunn wonders why we use one word for both. Yet he is not a despairing critic who sees modern democracy as a sham. Underlying it and the old kind alike he detects a basic and seemingly universal human preference for being persuaded rather than coerced.

Mr Dunn does recognise the distorting influence of money and special interests. He tells the story of democracy since the late 18th century as a conflict between egoism and equality, his code for free-market capitalism and social democracy. The first has triumphed, he tells us, at the second's expense. Historically at least, that judgment sounds too stark. Modern capitalism has survived and flourished not just by delivering the goods. It came through many 19th- and 20th-century crises thanks in large part to state-provided stabilisers such as state schools, public welfare and social insurance that the party of equality wrung from the party of egoism.

Mr Dunn touches many other topics too. “Setting the People Free” is lucidly and provocatively written, even if the argument is too compressed at times for total comfort. Next time you hear the word democracy, reach for this book. If you want to think harder about democracy's shortcomings and challenges, it is an excellent place to start.

Setting the People Free: The Story of Democracy.
By John Dunn.
Atlantic Books; 246 pages; £16.99. To be published in America by Grove Atlantic in January 2006

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New fiction

Paris fashion

Jun 16th 2005
From The Economist print edition

“TWILIGHT” is an old-fashioned novel in the most satisfying sense. Impeccably rendered, Katherine Mosby's elegant, perceptive prose recalls Edith Wharton. Her novel begins before the first world war and concludes midway through the second. Lavinia Gibbs is born to a prominent New York family but is resistant to the expectations that good breeding and femininity impose. Rashly, she breaks off her engagement to a solid but repressive financier, scandalising her parents and exiling herself to France. In Paris, she violates yet another social rubric by falling in love with a married man, a well-read, clever romantic who is also a bit of a cad.

Twilight
By Katherine Mosby

HarperCollins; 304 pages; $24.95.

Buy it at
Amazon.com
Amazon.co.uk

The gradually more insistent incursions of the second world war are deftly brought to bear on Lavinia's heady affair. A sense of gathering tragedy in both the wider world of history and the smaller one of love provide the story with a powerful forward thrust. Yet the greatest pleasures of this novel are single sentences, which evidence a fluidity and grace that is rare in contemporary fiction. Lavinia despairs of clumsy language: “It is one thing to be merely prosaic, but to use words in a way that perverted their potential or denigrated their power was something that violated Lavinia's aesthetic principles.”

The hand of Lavinia's betrothed “fluttered involuntarily as if it were the only part of him sensitive enough to register emotion or disobedient enough to display it.” During Lavinia's engagement, “her views were solicited even by men who previously would have let her erudition and wit go unacknowledged rather than risk having its appreciation misconstrued.” For the two lovers, war “intensified the sense of abandon with which they met and the sense of abandonment after they parted.” Moreover, eloquence is paired with incisive content: “It seemed particularly naive to believe that the object of a great love must necessarily be worthy of it.”

“Twilight” is made for those grumpy fuddy-duddies amongst us eternally griping, “Why don't they write them that way anymore?” Apparently, they do.

Twilight.
By Katherine Mosby.
HarperCollins; 304 pages; $24.95.

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Obituary

Adolfo Aguilar Zinser

Jun 16th 2005
From The Economist print edition

AFP/NOTIMEX

Adolfo Aguilar Zinser, an outspoken Mexican diplomat, died on June 5th, aged 55

FOR much of their shared 2,000-mile border, little distinguishes Mexico from the United States. Desert meets desert, and one dusty small town rubs up against another. Even in the cities, where American towers, cars and neon abut on shabby Mexican sprawl, business buildings—in this post-NAFTA age of increasingly interlinked economies—now look much the same on either side. Yet the balance of power, and the flow of people, remain unrelentingly and inevitably tilted to the huge, rich north.

So when Adolfo Aguilar Zinser, in a speech in November 2003, said that the United States saw Mexico as its *patio trasero*, or back yard, he believed it was nothing controversial. Indeed, it seemed to him "obvious and historical". Historical, because it dated at least from 1848, when American marines in occupation of Mexico City had forced Mexico to sign over half its land, more than half a million square miles, to the United States. He went further: in contrast to its long, settled relationships with Britain and others, he said, the United States saw its relations with Mexico as *un noviazgo de fin de semana*, a casual weekend fling.

His words, obvious or not, were the last straw. Mr Aguilar Zinser was Mexico's ambassador to the United Nations, and was supposed to behave. Vicente Fox, the president of Mexico, and George Bush—ranchers, businessmen, straight-talking conservative guys—were supposed to be trying to be friends. But the war on terror, the war in Iraq, and the instinctive anti-Americanism of the Mexican political elite had already pushed them apart; and Mr Aguilar Zinser, with his owlish mien and dandy's ties and defiantly outspoken remarks, had only made things worse.

He was not a gringo-basher by nature. His youth had seen him flirting with Marxism, quite usual for a member of the Class of 1968, and in the mid-1970s he had headed Luis Echeverría's Centre for Third World Economic and Social Studies, which sought to distance Mexico from the United States. But he had close associations with the Colossus of the North. He had studied international law at Harvard, acquiring perfect English, knew Washington well, and later taught at Berkeley.

Among Mexico's intelligentsia, with its navel-gazing tendency to bemoan the malign influence of the

United States on every facet of Mexican life, Mr Aguilar Zinser stood out as an internationalist and an enthusiast for democracy in an almost American mode. From 1994 onwards, first alongside a perpetual leftist candidate, Cuauhtémoc Cárdenas, and then with the rightist Mr Fox, he devoted his considerable energies to loosening the grip of the Institutional Revolutionary Party (PRI), whose soft and corrupt authoritarianism had ruled Mexico for seven decades.

Under Mr Fox, he might have been foreign minister. The job went to Jorge Castañeda, with whom he had made his journey across the political spectrum; the two men fell out over it, and seldom spoke afterwards. Mr Aguilar Zinser went to the UN, where Iraq loomed. As a lawyer, he did not think a military attack was legal; besides, most Mexicans were opposed to one. When the draft second resolution to allow the use of force came across his desk in early 2003 he took it apart, noting minutely how it departed from international law. As one of the ten non-permanent members of the Security Council, Mexico had some weight; with Mr Aguilar Zinser, it gained more. Five other countries joined him to resist American arm-twisting, and the United States was eventually obliged to abandon hope of a second resolution.

A letter to Vicente

He was never, he admitted, “a diplomatic diplomat”. He said exactly what he thought, even when Colin Powell, America's secretary of state, wagged his finger at him in public and privately pleaded, repeatedly, for him to be reined in. When a meeting of the six dissenters to draft an alternative resolution was bugged by the Americans and the British, Mr Aguilar Zinser spilled the beans to the newspapers. He became the very model of an intellectual typified by Mexico's great poet, Octavio Paz: not merely observing and commenting from some ivory tower, but fighting in the thick of things.

Occasionally, he would check with Mr Fox whether he was “overstepping his bounds”. No, replied the president; he would support him. Those words faded fast when Mr Bush for weeks refused to return Mr Fox's calls. The Mexican president never could give a firm yes or no to the Iraq war; but he could at least fire his ambassador to placate the Americans and, after the “back yard” speech, he did.

It brought him an impassioned letter of defiance. Throughout, Mr Aguilar Zinser called him “Vicente”; they had, after all, been friends. He retracted nothing he had said. Any Mexican, he wrote, would recognise that Mexico was abused, undervalued and downgraded in international circles, most of all by the United States. And “we cannot pretend that reality is different from what it is”.

One thing, however, gave him comfort. Mr Fox might play the subservient, suppliant ally. But as long as Mr Aguilar Zinser had been at the UN, no member of the Security Council had thought of Mexico as anyone's back yard.

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Overview

Jun 16th 2005
From The Economist print edition

The **euro** fell to a nine-month low against the dollar, coming within a whisker of $1.20.

Inflation eased in America. Producer prices dropped by 0.6% in May, and consumer prices fell by 0.1%, the first monthly decline since July 2004. The drop was largely due to a fall in energy prices. Excluding the volatile categories of fuel and food, core consumer prices edged upwards by 0.1%.

However, fuel may be about to become more expensive. The price of a barrel of West Texas Intermediate crude **oil** reached $56.75 during trading this week.

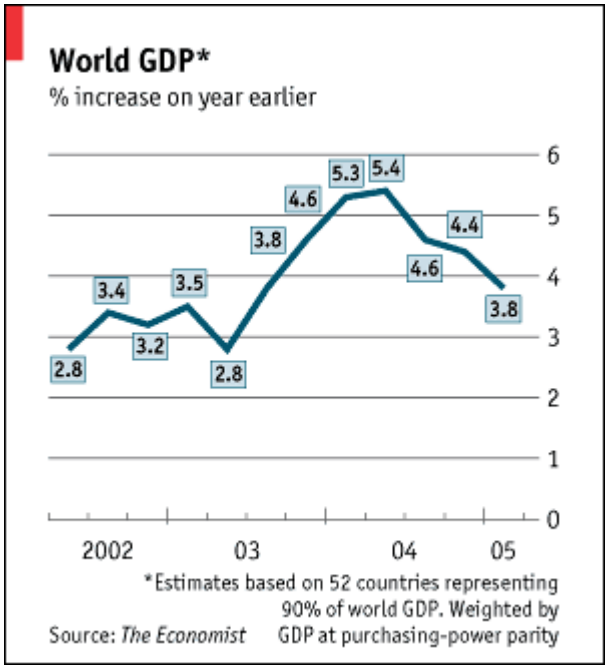
In **America**, industrial production expanded by 0.4% in May, leaving it 3.1% larger than a year ago. But the value of retail sales fell by 0.5% in the same month.

America's **trade deficit** in goods and services widened to $57 billion in April. Net inflows of capital totalled $47.4 billion in the same month.

Industrial output stagnated in **France**, but rebounded in **Italy**. French production failed to grow in the year to April, but Italian industrial output grew by 1.9% in April alone, leaving it 0.8% greater than a year ago.

In **Japan**, first-quarter GDP growth was revised downwards, from an annualised rate of 5.3% to 4.9%.

Britain's unemployment rate remained at 4.7% in April. Average earnings in the three months to April were 4.6% higher than a year ago. Consumer prices rose by 1.9% in the year to May.



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Output, demand and jobs

Jun 16th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q1	+ 2.8	+ 2.6	+ 3.2	– 0.4	Q4	+ 1.8	Q1	5.1	May	5.5
Austria	+ 2.0	Q1	+ 0.8	+ 2.0	+ 2.0	+ 1.9	Mar	+ 3.2	Mar	4.6	May	4.4
Belgium	+ 1.8	Q1	– 0.1	+ 1.6	+ 2.1	– 1.5	Apr	+ 3.4	Mar	12.3	Apr†	12.4
Britain	+ 2.7	Q1	+ 2.0	+ 2.4	+ 2.1	– 1.9	Apr	+ 1.3	May	4.7	Apr††	4.8
Canada	+ 3.3	Q1	+ 2.3	+ 2.6	+ 2.9	+ 1.3	Mar	+ 6.3	Feb	6.8	May	7.1
Denmark	+ 0.8	Q1	+ 0.6	+ 2.1	+ 2.2	– 2.4	Apr	+ 8.2	Apr	5.9	Apr	6.5
France	+ 1.7	Q1	+ 0.8	+ 1.8	+ 2.0	nil	Apr	+ 1.0	Apr	10.2	Apr	10.0
Germany	+ 1.1	Q1	+ 4.2	+ 1.1	+ 1.4	+ 1.8	Apr	nil	Mar	11.8	May§	10.5
Italy	– 0.2	Q1	– 1.8	+ 0.3	+ 1.3	+ 0.8	Apr	+ 1.2	Mar	8.0	Dec	8.2
Japan	+ 1.3	Q1	+ 4.9	+ 1.4	+ 1.8	+ 0.6	Apr	+ 0.7	Mar	4.4	Apr	4.7
Netherlands	– 0.3	Q1	– 0.6	+ 0.8	+ 1.6	– 0.7	Apr	+ 0.6	Mar	6.6	May**	6.5
Spain	+ 3.3	Q1	+ 3.5	+ 2.8	+ 2.7	+ 7.1	Apr	+ 3.0	Apr	10.0	Apr	11.2
Sweden	+ 1.4	Q1	+ 1.1	+ 2.8	+ 2.8	+ 4.4	Mar	+ 4.0	Apr	5.8	Apr†	5.4
Switzerland	+ 0.8	Q1	+ 0.2	+ 1.2	+ 1.7	+ 4.7	Q4	– 0.3	Mar	3.7	May†	3.8
United States	+ 3.7	Q1	+ 3.5	+ 3.5	+ 3.2	+ 3.1	Apr	+ 5.3	Apr	5.1	May	5.6
Euro area	+ 1.3	Q1	+ 2.0	+ 1.4	+ 1.8	– 0.1	Mar	– 0.9	Apr	8.9	Apr	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.0	Q1	+ 0.5	na	na	+ 1.2	Apr	+ 2.9	Mar	10.0	Apr†	10.6
Greece	+ 3.5	Q1	na	na	na	– 3.2	Apr	+ 7.1	Mar	10.2	Dec	9.8
Iceland	+ 2.9	Q1	na	na	na	na		na		2.6	Mar†	3.5
Ireland	+ 2.8	Q4	na	na	na	– 6.4	Apr	+ 4.6	Mar	4.2	May	4.6
Luxembourg	+ 3.8	Q4	na	na	na	+ 2.4	Mar	– 3.1	Apr	4.6	Apr	4.2
New Zealand	+ 3.6	Q4	+ 2.4	na	na	+ 3.5	Q4	+ 5.8	Q1	3.9	Q1	4.2
Norway	– 0.8	Q1	+ 2.2	na	na	+ 4.0	Apr	+ 8.5	Apr	4.6	Apr**	4.3
Portugal	+ 0.1	Q1	+ 0.8	na	na	+ 0.7	Apr	+ 2.0	Apr	7.5	Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 2.7% in May. §EU harmonised rate 9.6% in Apr. **Mar-May.

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Prices and wages

Jun 16th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.4	Q1	+ 2.0	+ 2.6	+ 2.6	+ 6.0	Q1	– 1.1	+ 4.5	Q1	+ 5.0
Austria	+ 2.3	May	+ 2.1	+ 2.1	+ 1.6	+ 1.3	May	+ 6.1	+ 2.3	May	+ 2.1
Belgium	+ 2.5	May	+ 2.6	+ 2.0	+ 1.7	+ 3.3	Apr	+ 2.6	+ 2.6	Apr	+ 2.3
Britain	+ 1.9	May*	+ 1.5	+ 1.9	+ 1.9	+ 2.7	May	+ 2.5	+ 4.6	Apr†	+ 4.4
Canada	+ 2.4	Apr	+ 1.6	+ 2.1	+ 2.1	+ 1.5	Apr	+ 2.3	+ 2.5	Feb	+ 3.5
Denmark	+ 1.5	May	+ 1.3	+ 1.4	+ 1.7	+ 3.8	Apr	+ 1.6	+ 3.1	Q1	+ 3.3
France	+ 1.5	May	+ 2.6	+ 1.6	+ 1.6	+ 3.1	Apr	+ 1.3	+ 2.9	Q1	+ 2.8
Germany	+ 1.7	May	+ 2.0	+ 1.4	+ 1.0	+ 1.7	May	+ 3.6	+ 1.5	Mar	+ 1.5
Italy	+ 1.9	May	+ 2.3	+ 1.9	+ 1.8	+ 4.4	Apr	+ 1.7	+ 3.5	Apr	+ 2.8
Japan	nil	Apr	– 0.4	– 0.1	+ 0.3	+ 1.8	May	+ 0.9	+ 0.5	Apr	+ 1.2
Netherlands	+ 1.3	May	+ 1.5	+ 1.4	+ 0.6	+ 4.7	Apr	+ 2.3	+ 0.6	May	+ 1.5
Spain	+ 3.1	May	+ 3.4	+ 2.9	+ 2.7	+ 5.0	Apr	+ 2.6	+ 3.0	Q1	+ 3.2
Sweden	+ 0.1	May	+ 0.7	+ 0.7	+ 1.5	+ 2.7	Apr	– 0.2	+ 4.2	Mar	+ 1.5
Switzerland	+ 1.0	May	+ 0.9	+ 1.2	+ 1.2	+ 1.3	Apr	+ 0.7	+ 0.9	2004	+ 1.4
United States	+ 2.8	May	+ 3.1	+ 2.9	+ 2.5	+ 3.5	May	+ 4.7	+ 2.6	May	+ 2.0
Euro area	+ 2.0	May	+ 2.5	+ 1.8	+ 1.5	+ 4.2	Apr	+ 1.4	+ 2.2	Q4	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.8	May	– 0.1	na	na	+ 3.1	Apr	+ 0.5	+ 4.1	Q1	+ 4.2
Greece	+ 3.2	May	+ 2.9	na	na	+ 4.3	Apr	+ 4.6	na		na
Iceland	+ 2.8	Jun	+ 3.9	na	na	+ 4.5	May	+ 5.0	+ 6.7	Apr	+ 4.0
Ireland	+ 2.4	May	+ 1.7	na	na	– 1.8	Apr	– 4.1	+ 5.1	Q4	+ 4.5
Luxembourg	+ 2.4	May	+ 2.3	na	na	+ 8.9	Apr	+ 6.2	+ 0.6	Feb	+ 4.0
New Zealand	+ 2.8	Q1	+ 1.5	na	na	+ 4.2	Q1	– 0.6	+ 2.5	Q1	+ 2.2
Norway	+ 1.6	May	+ 1.0	na	na	+ 9.2	May	+18.8	+ 3.7	Q1	+ 3.5
Portugal	+ 2.1	Apr	+ 2.3	na	na	+ 4.4	Apr	+ 1.1	– 1.6	Apr	– 1.4

*RPI inflation rate 2.9% in May. †Feb-Apr.

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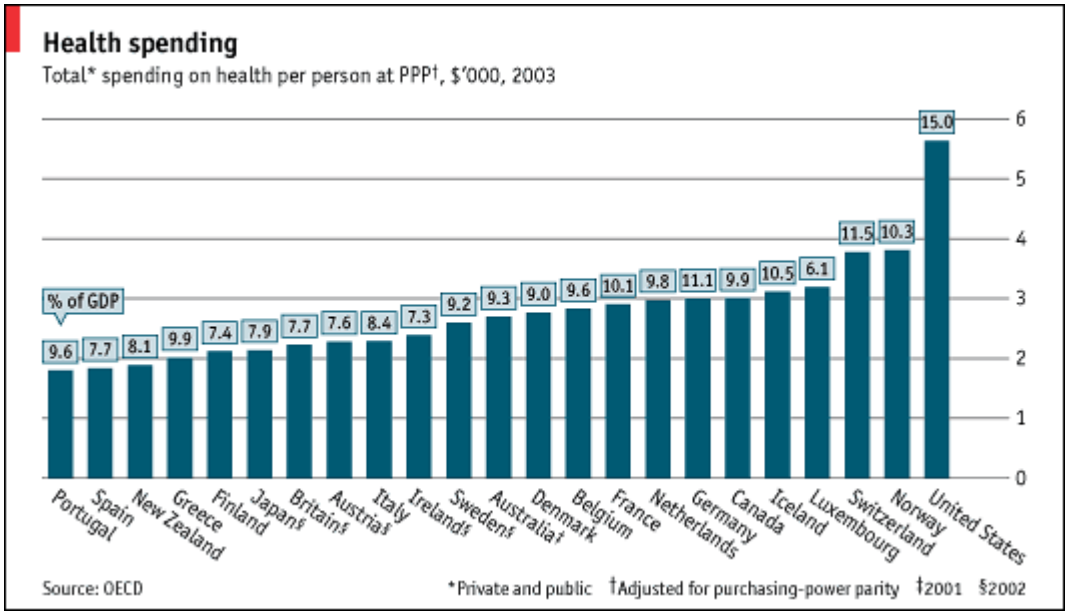
Health spending

Jun 16th 2005
From The Economist print edition



In 2003, America spent $5,635 per person on health care, more than twice the average in rich economies, according to a new OECD report. Britain spent only $2,231 per person. Health spending accounted for 15% of America's GDP. Germany, France, Switzerland, Norway and Iceland also spent over 10% of GDP on health. America is the only country where more than half of all health spending is within the private sector.

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Money and interest rates

Jun 16th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Jun 15th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.0	+ 9.0	Apr	5.67	5.49	5.24	5.25	5.92	6.34
Britain	+ 4.8	+10.4	Apr	4.81	4.75	4.33	4.39	5.19	5.20
Canada	+13.5	+10.8	Apr	2.43	1.94	2.94	4.00	5.29	5.23
Denmark	+17.7	+11.3	Apr	2.20	2.25	2.12	3.20	4.49	4.92
Japan	+ 4.0	+ 1.5	May	0.02	0.02	0.07	1.22	1.86	1.31
Sweden	+ 2.2	+ 3.7	Apr	1.65	1.96	1.94	3.16	4.64	2.83
Switzerland	– 7.1	+ 2.1	Apr	0.75	0.42	0.88	2.04	2.87	1.91
United States	+ 2.0	+ 4.5	Apr	3.26	1.45	3.71	4.11	4.73	5.13
Euro area†	+ 9.3	+ 6.7	Apr	2.11	2.12	2.09	3.25	4.32	3.45

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.40%, Japan No. 270 1.24%. Central bank rates: US fed funds 3.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 16th 2005
From The Economist print edition

2000=100

	Jun 7th	Jun 14th*	% change on one month	% change on one year
Dollar index				
All items	135.4	133.5	+ 2.9	+ 2.0
Food	130.4	129.3	+ 3.1	– 3.1
Industrials				
All	141.8	139.0	+ 2.5	+ 9.0
Nfa†	130.1	128.7	+ 0.6	– 7.6
Metals	148.2	144.6	+ 3.5	+19.4
Sterling index				
All items	112.2	112.0	+ 4.7	+ 2.7
Euro index				
All items	102.0	102.5	+ 7.9	+ 2.3
Yen index				
All items	134.0	135.4	+ 4.8	+ 1.3
Gold				
$ per oz	425.25	426.85	+ 1.5	+10.4
West Texas Intermediate				
$ per barrel	53.76	54.95	+12.3	+48.0

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Jun 16th 2005
From The Economist print edition

Market indices

	Jun 15th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,203.8	4,255.8	3,905.5	+ 0.7	– 1.2	+ 3.7	+ 1.5
Austria (ATX)	2,948.0	2,948.0	2,415.0	+ 3.5	nil	+21.2	+ 8.0
Belgium (Bel 20)	3,109.4	3,197.3	2,958.8	+ 1.6	–15.5	+ 6.0	– 5.5
Britain (FTSE 100)	5,019.5	5,060.8	4,783.6	+ 0.3	–27.6	+ 4.3	– 1.2
Canada (Toronto Composite)	9,866.6	9,927.2	9,006.2	+ 1.6	–13.4	+ 6.7	+ 3.1
Denmark (KBX)	303.8	304.0	257.8	+ 1.7	– 0.1	+17.9	+ 4.9
France (SBF 250)	2,905.6	2,916.8	2,633.6	+ 0.4	–33.8	+10.3	– 1.7
(CAC 40)	4,184.4	4,203.5	3,816.1	+ 0.3	–39.6	+ 9.5	– 2.4
Germany (DAX)*	4,548.4	4,599.2	4,178.1	– 0.2	–43.6	+ 6.9	– 4.8
Italy (S&P/MIB)	32,622.0	32,856.0	30,645.0	+ 1.3	–34.9	+ 5.6	– 6.0
Japan (Nikkei 225)	11,415.9	11,966.7	10,825.4	+ 1.2	–70.7	– 0.6	– 6.8
(Topix)	1,158.2	1,203.3	1,109.2	+ 0.8	–59.9	+ 0.7	– 5.5
Netherlands (AEX)	375.8	379.8	347.0	+ 0.8	–46.4	+ 8.0	– 3.8
Spain (Madrid SE)	1,036.3	1,042.7	950.9	+ 0.7	– 9.6	+ 8.1	– 3.7
Sweden (Affarsvarlden Gen)	242.2	243.2	218.9	+ 1.1	–39.5	+ 9.5	– 5.1
Switzerland (Swiss Market)	6,257.1	6,268.4	5,669.6	+ 0.3	–25.6	+ 9.9	– 1.7
United States (DJIA)	10,566.4	10,940.6	10,012.4	+ 0.9	– 9.9	– 2.0	– 2.0
(S&P 500)	1,206.6	1,225.3	1,137.5	+ 1.0	–21.0	– 0.4	– 0.4
(NASDAQ Comp)	2,074.9	2,152.2	1,904.2	+ 0.7	–58.9	– 4.6	– 4.6
Europe (FTSEurofirst 300)†	1,132.4	1,136.9	1,038.6	+ 0.8	–33.6	+ 8.7	– 3.2
Euro area (FTSE Euro 100)†	957.2	961.7	894.4	+ 0.7	–38.3	+ 6.2	– 5.3
World (MSCI)‡	1,152.6	1,193.0	1,115.0	+ 0.1	–20.4	– 1.4	– 1.4
World bond market (Citigroup)††	637.1	662.3	636.7	– 2.1	– 3.8	– 4.4	– 4.4

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 16th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Jun 15th	year ago	Currency units per $ Jun 15th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 18.1	Apr	− 42.4	Q1	− 5.7	− 5.1	117.9	107.3	1.30	1.45	2.37	1.58	1.19	+ 0.9
Austria	nil	Mar	− 0.4	Mar	− 0.5	− 0.6	104.8§	103.6	0.83	0.83	1.50	–	0.76	− 2.0
Belgium	+ 16.7	Mar	+ 12.0	Dec	+ 3.3	+ 3.3	105.5§	103.9	0.83	0.83	1.50	–	0.76	− 0.5
Britain	−109.9	Apr	− 49.0	Q4	− 2.5	− 2.5	101.4	103.0	0.55	0.55	–	0.67	0.50	− 2.9
Canada	+ 49.1	Apr	+ 20.2	Q1	+ 1.7	+ 1.5	116.4	104.9	1.24	1.38	2.26	1.50	1.13	+ 1.2
Denmark	+ 9.2	Apr	+ 8.5	Apr	+ 2.1	+ 2.1	105.5	105.7	6.15	6.19	11.2	7.44	5.62	+ 1.8
France	− 22.4	Apr	− 10.9	Mar	− 0.3	− 0.1	108.3§	106.4	0.83	0.83	1.50	–	0.76	− 3.0
Germany	+198.5	Apr	+108.0	Apr	+ 3.4	+ 3.2	106.2§	104.0	0.83	0.83	1.50	–	0.76	− 3.5
Italy	− 6.1	Apr	− 18.8	Mar	− 1.2	− 1.2	77.5§	76.2	0.83	0.83	1.50	–	0.76	− 4.4
Japan	+125.3	Apr	+170.9	Apr	+ 3.6	+ 3.6	87.5	87.7	109	110	199	132	–	− 6.1
Netherlands	+ 38.7	Apr	+ 33.9	Q1	+ 3.4	+ 3.4	105.0§	103.2	0.83	0.83	1.50	–	0.76	− 2.2
Spain	− 83.1	Mar	− 55.5	Feb	− 4.9	− 4.9	77.8§	76.9	0.83	0.83	1.50	–	0.76	+ 0.5
Sweden	+ 23.0	Apr	+ 29.7	Q1	+ 6.9	+ 6.3	96.2	97.6	7.67	7.63	13.9	9.28	7.01	+ 0.8
Switzerland	+ 7.0	Apr	+ 40.8	Q4	+11.1	+10.6	106.8	107.9	1.27	1.27	2.31	1.54	1.16	− 1.0
United States	−709.7	Apr	−665.9	Q4	− 6.3	− 6.2	85.7	88.3	–	–	1.82	1.21	0.91	− 4.1
Euro area	+ 74.9	Mar	+ 42.1	Mar	+ 0.5	+ 0.5	114.3	113.6	0.83	0.83	1.50	–	0.76	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.1	Mar	+ 11.8	Apr	na	na	82.4§	81.0	0.83	0.83	1.50	–	0.76	+ 1.3
Greece	− 33.0	Mar	− 10.7	Mar	na	na	60.4§	59.6	0.83	0.83	1.50	–	0.76	− 3.8
Iceland	− 0.7	Apr	− 1.0	Q4	na	na	105.7**	98.7	66.0	72.6	120	80.0	60.4	+ 1.1
Ireland	+ 40.7	Mar	− 0.8	Q4	na	na	95.9§	93.2	0.83	0.83	1.50	–	0.76	− 0.7
Luxembourg	− 4.6	Mar	+ 2.9	Q4	na	na	105.5§	103.9	0.83	0.83	1.50	–	0.76	− 0.8
New Zealand	− 3.0	Apr	− 6.2	Q4	na	na	138.4	125.4	1.41	1.59	2.57	1.71	1.29	+ 3.2
Norway	+ 41.9	May	+ 34.4	Dec	na	na	109.9	104.1	6.52	6.92	11.9	7.90	5.97	+ 14.4
Portugal	− 19.6	Mar	− 13.9	Mar	na	na	94.3**	94.0	0.83	0.83	1.50	–	0.76	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. ††New series. **IMF, February average.

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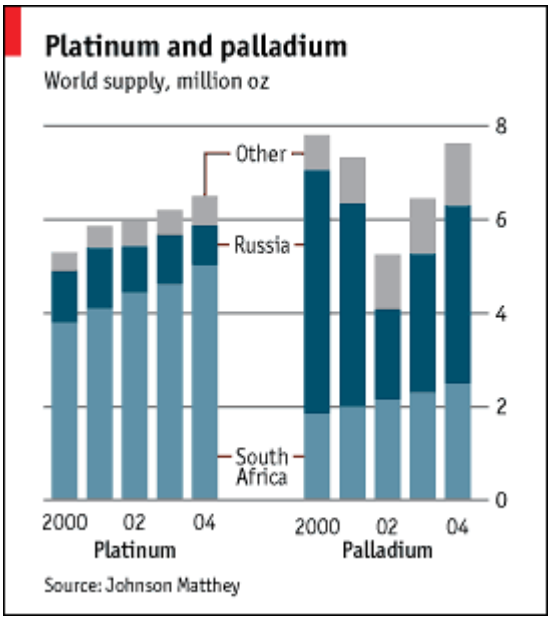
Platinum and palladium

Jun 16th 2005
From The Economist print edition

World palladium supplies grew by 18% in 2004 as Russia sold metal from its stockpile. Platinum supplies rose by only 5%. South Africa's output was a record, but Russia's was the lowest for five years.



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Overview

Jun 16th 2005
From The Economist print edition

In **China**, industrial output increased by 16.6% in the year to May. A big trade surplus that month pushed up the 12-month surplus to $71.1 billion. Consumer-price inflation stayed at 1.8% over the same 12 months.

In **India**, industrial production rose by 8.8% in the year to April. Over the same period industrial output also grew rapidly in **Mexico** and **South Africa**, by 5.2% and 7.1% respectively.

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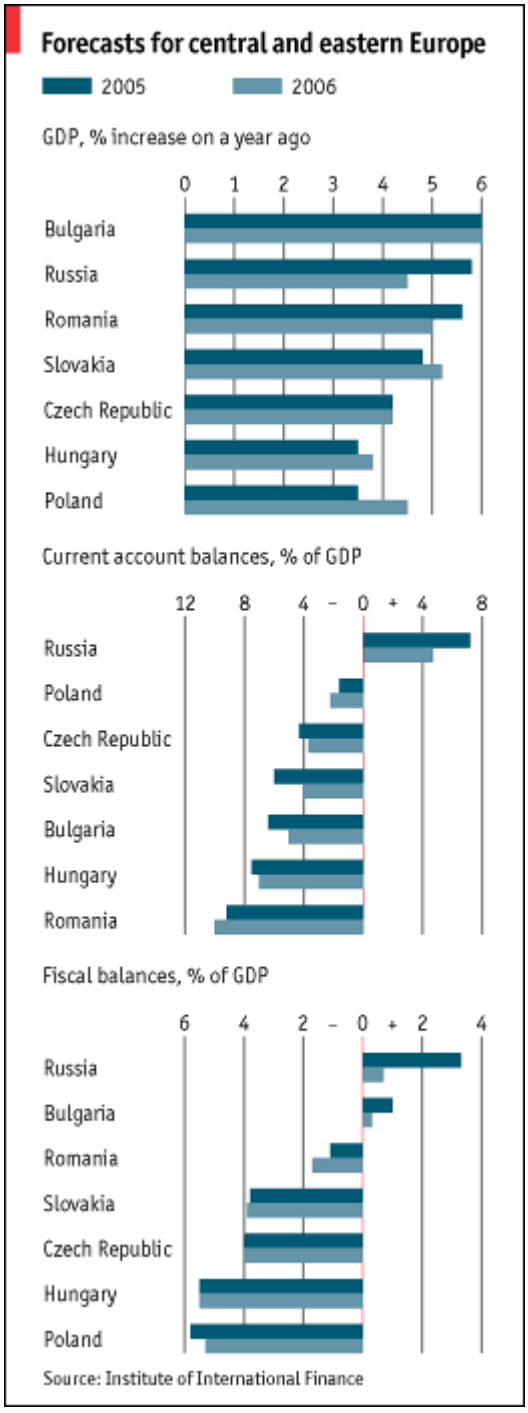
Forecasts for central and eastern Europe

Jun 16th 2005
From The Economist print edition

Many economies in central and eastern Europe will see slower growth this year thanks to weaker foreign demand and stronger currencies, says a new report by the Institute of International Finance. Romania's economy is expected to slow sharply, from 8.3% in 2004 to 5.6% in 2005. But in the Czech Republic output will be buoyed by strong inflows of foreign direct investment.



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Economy

Jun 16th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.4	Q1	+16.6	May	+ 1.8	May	+71.1	May	+68.7	2004	659.1	Mar
Hong Kong	+ 6.0	Q1	+ 5.0	Q4	+ 0.5	Apr	−10.2	Apr	+16.4	Q4	122.4	May
India	+ 6.2	Q4	+ 8.8	Apr	+ 5.0	Apr	−28.9	Apr	− 3.9	Q4	134.0	May
Indonesia	+ 6.4	Q1	+10.1	Mar	+ 7.4	May	+27.5	Apr	+ 2.9	Q4	35.1	Apr
Malaysia	+ 5.7	Q1	+ 6.8	Apr	+ 3.1	May	+23.3	Apr	+15.1	Q4	73.0	Apr
Philippines	+ 4.6	Q1	+ 2.8	Mar	+ 8.5	May	nil	Mar	+ 2.1	Dec	14.8	May
Singapore	+ 2.5	Q1	+ 4.8	Apr	+ 0.4	Apr	+15.9	Apr	+29.2	Q1	116.0	May
South Korea	+ 2.7	Q1	+ 3.8	Apr	+ 3.1	May	+27.6	May	+25.4	Apr	206.3	Apr
Taiwan	+ 2.5	Q1	+ 0.6	Apr	+ 2.3	May	+ 2.6	May	+16.9	Q1	253.2	May
Thailand	+ 3.3	Q1	+ 5.1	Apr	+ 3.7	May	− 3.2	Apr	+ 2.0	Apr	48.1	Apr
Argentina	+ 8.4	Q4	+ 7.4	Apr	+ 8.6	May	+11.6	Apr	+ 3.0	Q4	20.1	Apr
Brazil	+ 2.9	Q1	+ 6.3	Apr	+ 8.1	May	+38.1	May	+14.3	Apr	61.1	Apr
Chile	+ 5.7	Q1	+10.1	Apr	+ 2.7	May	+ 8.6	May	+ 1.1	Q1	17.3	May
Colombia	+ 4.3	Q4	nil	Feb	+ 5.0	May	+ 0.8	Jan	− 1.1	Q4	13.1	Apr
Mexico	+ 2.4	Q1	+ 5.2	Apr	+ 4.6	May	− 9.8	Apr	− 8.7	Q1	62.8	Apr
Peru	+ 6.4	Apr	+ 7.1	Apr	+ 1.8	May	+ 3.2	Mar	+ 0.4	Q1	12.8	Apr
Venezuela	+ 7.9	Q1	+ 0.1	Mar	+17.4	May	+22.6	Q1	+14.9	Q1	19.9	Mar
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 5.6	Mar	− 9.0	Q4	+ 4.3	Q4	16.8	Apr
Israel	+ 3.9	Q1	+ 3.3	Mar	+ 0.2	May	− 7.2	May	+ 0.5	Q4	26.5	May
South Africa	+ 4.2	Q1	+ 7.1	Apr	+ 3.4	Apr	− 2.1	Apr	− 7.0	Q4	15.5	May
Czech Republic	+ 4.4	Q1	+ 5.7	Apr	+ 1.3	May	+ 0.5	Apr	− 4.4	Q1	27.1	May
Hungary	+ 2.9	Q1	+ 8.9	Apr	+ 3.6	May	− 2.9	Q4	− 8.8	Q4	17.5	May
Poland	+ 2.1	Q1	− 1.0	Apr	+ 2.5	May	− 4.9	Mar	− 2.8	Mar	39.3	Apr
Russia	+ 4.9	Q1	+ 5.0	Apr	+13.6	May	+100.9	Apr	+69.7	Q1	143.6	May
Turkey	+ 6.3	Q4	+ 5.1	Apr	+ 8.7	May	−36.3	Apr	−17.2	Apr	37.3	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 7.0	Q1	+11.3	Apr	+ 2.8	May	− 1.8	Mar	− 1.4	Q4	1.7	Apr
Latvia	+ 7.4	Q1	+ 0.8	Mar	+ 6.3	May	− 3.0	Apr	− 1.7	Mar	2.0	Apr
Lithuania	+ 5.5	Q1	na		+ 2.0	May	− 2.9	Mar	− 1.6	Q4	3.6	Apr
Slovakia	+ 5.1	Q1	+ 5.1	Apr	+ 2.4	May	− 1.9	Apr	− 1.8	Mar	17.6	Apr
Slovenia	+ 2.6	Q1	− 3.8	Mar	+ 2.2	May	− 1.4	Apr	− 0.3	Mar	8.4	Mar
Pakistan	+ 6.4	2004†	+28.3	Nov	+ 9.8	May	− 6.2	May	− 1.5	Q1	10.7	Apr
Saudi Arabia	+ 5.2	2004	na		+ 0.6	Mar	+84.9	2004	+51.5	2004	22.9	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Jun 16th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 15th		Dec 31st 2004	
	Jun 15th	year ago	Jun 15th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.1	3.38	1,126.3	– 3.8	– 15.3	– 15.3
Hong Kong	7.77	7.80	14.1	3.36	13,914.3	+ 0.1	– 2.2	– 2.2
India	43.6	45.3	79.3	5.23	6,907.0	+ 0.7	+ 4.6	+ 4.4
Indonesia	9,608	9,407	17,479	8.30	1,119.6	+ 2.2	+ 11.9	+ 8.1
Malaysia	3.80	3.80	6.91	2.85	900.3	+ 2.4	– 0.8	– 0.8
Philippines	55.3	56.2	100.5	6.56	1,992.4	+ 2.0	+ 9.3	+ 11.0
Singapore	1.67	1.72	3.04	2.06	2,201.9	+ 0.2	+ 6.6	+ 3.9
South Korea	1,013	1,158	1,842	3.52	1,001.9	+ 2.6	+ 11.8	+ 14.3
Taiwan	31.4	33.5	57.1	1.40	6,252.1	+ 1.5	+ 1.8	+ 2.8
Thailand	40.9	41.0	74.4	2.75	687.5	+ 0.5	+ 2.9	– 2.3
Argentina	2.86	2.96	5.21	5.69	1,453.7	– 2.4	+ 5.7	+ 9.7
Brazil	2.44	3.15	4.44	19.75	25,481.4	+ 3.2	– 2.7	+ 5.7
Chile	589	650	1,071	4.08	9,391.4	+ 0.8	+ 4.8	– 1.1
Colombia	2,330	2,727	4,238	7.21	5,167.5	+ 5.1	+ 18.9	+ 20.1
Mexico	10.8	11.4	19.7	9.62	13,501.5	+ 3.0	+ 4.5	+ 7.6
Peru	3.25	3.48	5.91	3.00	3,989.3	– 1.0	+ 7.5	+ 8.4
Venezuela	2,630§	2,657§	4,784	12.59	22,092.6	+ 0.4	– 26.2	– 27.7
Egypt	5.80	6.18	10.54	9.51	38,986.2	+ 5.3	+ 58.6	+ 66.1
Israel	4.47	4.51	8.14	3.61	686.4	– 2.8	+ 6.6	+ 2.9
South Africa	6.81	6.54	12.4	7.05	14,210.7	+ 1.5	+ 12.3	– 7.2
Czech Republic	24.8	26.4	45.1	1.75	1,196.8	+ 1.7	+ 16.0	+ 4.4
Hungary	206	211	374	7.08	18,428.7	+ 3.8	+ 25.0	+ 9.9
Poland	3.35	3.80	6.10	5.26	27,827.4	+ 1.5	+ 4.5	– 6.7
Russia	28.6	29.0	52.0	13.00	681.5‡	+ 1.4	+ 14.4	+ 11.0
Turkey	1.37	1.50	2.50	16.21	26,209.4	+ 1.7	+ 5.0	+ 3.0
EM (MSCI)*	1.00	1.00	1.82	na	562.6	+ 1.3	+ 3.8	+ 3.8
EMBI+†	1.00	1.00	1.82	na	341.7	– 0.1	+ 3.7	+ 3.7

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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